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**Before the United States Senate
Committee on the Judiciary**

**“Foreclosure Mediation Programs: Can Bankruptcy Courts
Limit Homeowner and Investor Losses?”**

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Senator Whitehouse, Senator Grassley, and members of the Committee, thank you for holding this hearing and for inviting me to testify today concerning the potential role of bankruptcy court loss mitigation programs as an effective tool in addressing our foreclosure crisis and limiting losses to homeowners and investors. I testify here today on behalf of the low income clients of the National Consumer Law Center (NCLC),¹ as well as on behalf of the National Association of Consumer Bankruptcy Attorneys.² The clients and constituencies of NCLC and NACBA collectively encompass a broad range of families and households who have been affected by the current foreclosure crisis.

The Treasury Department's Home Affordable Modification Program (HAMP) has failed to reach its goals because it has relied upon the voluntary efforts of servicers, and

¹ The National Consumer Law Center, Inc. (NCLC) is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of eighteen practice treatises and annual supplements on consumer credit laws, including *Consumer Bankruptcy Law and Practice* (9th ed. 2009); *Foreclosures* (3d ed. 2010); *Truth In Lending* (6th ed. 2007) and *Cost of Credit: Regulation, Preemption, and Industry Abuses* (4th ed. 2009), as well as bimonthly newsletters on a range of topics related to consumer credit and bankruptcy issues. NCLC attorneys have written and advocated extensively on all aspects of consumer law affecting low income people, conducted training for thousands of legal services and private attorneys on the law and litigation strategies to deal predatory lending and other consumer law problems, and provided extensive oral and written testimony to numerous Congressional committees on these topics. NCLC's attorneys have been closely involved with the enactment of all federal laws affecting consumer credit since the 1970s, and regularly provide extensive comments to the federal agencies on the regulations under these laws. This testimony was written with the assistance of Geoff Walsh, NCLC Staff Attorney.

² The National Association of Consumer Bankruptcy Attorneys (NACBA) is the only national organization dedicated to serving the needs of consumer bankruptcy attorneys and protecting the rights of consumer debtors in bankruptcy. NACBA has more than 5,000 members located in all 50 states and Puerto Rico. NACBA has been actively involved in promoting reasonable and fair bankruptcy legislation since it was founded in 1992.

no effective method of enforcement was incorporated into the program's design. I believe that legislation amending the Bankruptcy Code to give bankruptcy courts authority to modify home mortgages in Chapter 13 cases would have been the most effective way to encourage servicers to voluntarily modify home mortgages. Even without that amendment, however, bankruptcy courts can play an important role in assisting voluntary loan modifications through the adoption of loss mitigation programs. Legislation introduced by Senator Whitehouse (S. 222) would avoid unnecessary litigation by clarifying that bankruptcy courts have authority to set up such programs.

In my work as an attorney at NCLC, I provide training and technical assistance to attorneys and housing counselors across the country representing homeowners who are facing foreclosure. Because of my extensive experience in bankruptcy matters, I often speak at educational programs for bankruptcy attorneys, trustees and judges, and I serve as a member of the federal Judicial Conference Advisory Committee on Bankruptcy Rules. I was also appointed as Amicus Counsel to defend the Rhode Island Bankruptcy Court's Loss Mitigation Program from a legal challenge brought by two mortgage servicers. My testimony is based on this work and my many years of experience representing consumers in debt collection, bankruptcy and foreclosure defense matters, initially as an attorney with Rhode Island Legal Services and head of its Consumer Unit.

HAMP Has Failed to Curb the Foreclosure Crisis

The nation continues to endure the worst foreclosure crisis since the Great Depression. According to the Mortgage Bankers Association National Delinquency Survey for the fourth quarter of 2009, the combined percentage of loans in foreclosure or seriously delinquent was 15.02 percent, the highest ever recorded in the MBA

delinquency survey.³ Mortgage industry analysts estimate that, from the last quarter of 2008 through 2014, as many as 13 million foreclosures will be started.⁴

The primary government response to the foreclosure crisis has been HAMP, which was initiated by Treasury in 2009. However, HAMP is not providing a sufficient number of permanent loan modifications to homeowners.

Implementation of HAMP by servicers continues to be slow and hampered by administrative problems. While Treasury has made improvements to the program's design in the past year, the lack of compliance by servicers with program guidelines, and the inability of Treasury to enforce program requirements, continues to prevent HAMP from reaching its stated goals. The Administration's most recent report on HAMP progress shows that 549,620 permanent loan modifications have been made.⁵ Treasury had initially projected that HAMP would modify 3 to 4 million mortgages over a three year period. Assistant Treasury Secretary Herbert Allison, in responding to questioning in 2009 from the Senate Banking Committee, stated that the program would need to do 1 million modifications per year in order to meet Treasury's goals.⁶ With slightly more

³ Mortgage Bankers Association, *National Delinquency Survey Quarter 4 2009* (Feb. 19, 2010).

⁴ Goldman Sachs Global ECS Research, *Home Prices and Credit Losses: Projections and Policy Options* (Jan. 13, 2009), at 16; *see also* Rod Dubitsky, Larry Yang, Stevan Stevanovic & Thomas Suehr, Credit Suisse Fixed Income Research, *Foreclosure Update: Over 8 Million Foreclosures Expected* (Dec. 4, 2008) (predicting 9 million foreclosures for the period 2009-2012).

⁵ United States Department of the Treasury, *Making Home Affordable Program Servicer Performance Report Through November 2010*, available at: www.treasury.gov/initiatives/financial-stability/results/MHA-Reports/Documents/Nov%2010%20Report.pdf.

⁶ *Preserving Homeownership: Progress Needed to Prevent Foreclosures: Hearing Before the Senate Comm. on Banking, Housing & Urban Affairs*, 111th Cong. (July 16, 2009) (Senator Schumer's question of Assistant Treasury Secretary Herbert Allison).

than 500,000 permanent modifications made as we approach the program's two-year anniversary, HAMP is significantly lagging behind these early projections.

The recent Treasury report also suggests that the number of modifications being made is actually declining, with only 31,290 trial modifications and 29,972 permanent modifications made in November 2010. Moreover, even if HAMP reached its stated goals, the majority of all foreclosures would still be unaddressed.

Another huge problem that developed in the first year of HAMP is that a large number of homeowners were put on temporary loan modifications and then denied permanent modifications. Treasury's November, 2010 report shows that 729,109 homeowners have had their trial modifications canceled since the start of the program. Although trial modifications are intended to last only for three months, many homeowners have been making payments on trial plans for a year or more before even receiving a decision that their permanent modification has been denied based purportedly on some program eligibility requirement. These homeowners are often worse off at this point because they now face renewed foreclosure proceedings and a large arrearage resulting from the difference between their trial plan payment and their regular unmodified mortgage payment. For homeowners who were not in default when they went on the trial modification, they now have negative credit reports that will hurt any chance they may have had to obtain a loan refinancing.

Perhaps the biggest problem with HAMP is that it is effectively the "only game in town." No other national program has been put in place to assist homeowners in foreclosure. To make matters worse, HAMP has relied solely on the voluntary efforts of mortgage servicers to implement the program, and these efforts have been woefully

inadequate. Neither Congress nor Treasury has developed an enforcement mechanism to combat servicer noncompliance with HAMP. Treasury has used various incentives to encourage servicer participation, but these carrots have not resulted in servicer compliance with HAMP guidelines. Moreover, Congress' failure to amend the Bankruptcy Code to permit mortgage modifications in bankruptcy court has meant that homeowners have not had an effective stick to leverage modifications both in and outside bankruptcy.

Bankruptcy Court Mediation and Loss Mitigation Programs.

The bankruptcy court for the Southern District of New York established the first formal Loss Mitigation Program (LMP) in 2009,⁷ followed soon after by a similar program implemented by the bankruptcy court in Rhode Island.⁸ A more limited program designed in coordination with the state court foreclosure mediation program has been adopted by the bankruptcy court in Vermont.⁹ The stated purpose of the LMPs is to “bring debtors and secured lenders together, to encourage them to discuss mutually beneficial financial resolution of their home mortgage difficulties...”¹⁰ and “to facilitate resolution by opening the lines of communication between the debtors’ and lenders’ decision-makers.”¹¹ Consistent with the goal of court-annexed mediation and alternative

⁷ See *In re* Adoption of Loss Mitigation Program Procedures, General Order M-364 (Dec. 18, 2008), amended by General Order M - 413 (Dec. 30, 2010), *available at*: www.nysb.uscourts.gov/orders/m364.pdf. Several of the judges in the E.D. of New York have also adopted the program.

⁸ See General Order Adopting Second Amended Loss Mitigation Program and Procedures 10-002 (Aug. 23, 2010), amending General Orders 09-003 and 10-001; *available at* <http://www.rib.uscourts.gov/newhome/RulesInfo/generalorders.asp>.

⁹ Vermont Standing Order 10-01, July 1, 2010, *available at*: <http://www.vtb.uscourts.gov/orders/ord10-01.pdf>.

¹⁰ *In re* Simarra, 2010 WL 2144150, * 1 (Bankr. D.R.I. April 14, 2010).

¹¹ New York General Order M-413, p. 1.

dispute resolution programs, LMPs are intended to “avoid or reduce unnecessary bankruptcy litigation and cost to debtors and secured creditors.”¹² In this respect these programs fall squarely within authority granted to bankruptcy courts under Bankruptcy Code section 105(d) and Bankruptcy Rule 7016.

The bankruptcy court programs are similar to the numerous programs adopted nationwide by state and local courts in response to the foreclosure crisis. These courts have recognized the need for a degree of heightened judicial supervision over foreclosures to help avoid hundreds of thousands of families from losing their homes unnecessarily. County courts serving such large cities as Chicago, Philadelphia, Cleveland, and Pittsburgh have implemented foreclosure conference and mediation programs similar to the Rhode Island and New York Loss Mitigation Programs.¹³ Courts in smaller cities, as diverse as Santa Fe, New Mexico and Louisville, Kentucky, have followed suit.¹⁴

In addition to these initiatives from local courts, state supreme courts have implemented similar programs. The New Jersey Supreme Court promulgated rules for a

¹² Rhode Island General Order 09-003.

¹³ Chicago, Philadelphia, Cleveland, Pittsburgh Cook County Chicago Court Program: <http://cookcountyforeclosurehelp.org/about/>; Philadelphia County: http://s98001.gridserver.com/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/pa_philly_pilot_program.pdf; Cuyahoga County (Cleveland): http://s98001.gridserver.com/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/ohio_prgm_summary.pdf; Allegheny County (Pittsburgh): http://s98001.gridserver.com/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/pa_pitts_admin_order.pdf

¹⁴ Santa Fe First Judicial District Admin Order: http://s98001.gridserver.com/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/nm_admin_order.pdf Jefferson County Kentucky Admin Order: http://s98001.gridserver.com/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/kentucky_admin_order.pdf.

uniform statewide foreclosure mediation program.¹⁵ In Delaware, the president judge of the state's superior courts issued a mediation rule applicable to all the state's superior courts.¹⁶ The Ohio Supreme Court has established a model program which common pleas courts in many of the state's most populous counties have implemented.¹⁷ Florida's Supreme Court has implemented a statewide initiative that requires mediation automatically in all foreclosure cases filed in that state.¹⁸

In addition to these court-initiated programs, the legislatures in several states have recently enacted statutes which direct state courts to implement various forms of conference and mediation programs for foreclosure cases. These include programs now in effect in Connecticut, Indiana, Maine, New York, and Vermont.¹⁹ In the non-judicial foreclosure states of California, Oregon, Maryland, Michigan, and Nevada the

¹⁵ <http://www.nj.gov/foreclosuremediation/resources.html>.

¹⁶ <http://www.deforeclosurehelp.org/mediation.html>.

¹⁷ *See:*

http://s98001.gridserver.com/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/ohio_prgm_model.pdf. Cities with programs in effect include Cleveland, Cincinnati, Columbus, Toledo, and Akron.

¹⁸ Florida Supreme Court: No. AOSC09-54 *Re: Final Report and recommendations on residential Mortgage Foreclosure Cases* (December 28, 2009)

http://www.floridasupremecourt.org/pub_info/documents/AOSC09-54_Foreclosures.pdf.

¹⁹ Connecticut (Conn. Gen. Stat. Ann. § 8-265ee); Indiana (2009 Senate Enrolled Act No. 492); Maine (14 Maine Rev. Stat. Ann. § 6321-A); New York (New York Civil Practice Laws Rule § 3408); Vermont (2010 House Bill 590). The Supreme Court of South Carolina has issued an administrative order that, while not requiring a specific form of conference, requires servicers to certify completion of HAMP-related loss mitigation reviews as a condition to proceeding with a foreclosure in the state. S.C. Administrative Order No. 2009--05-22-01 *Re: Mortgage Foreclosures and the Home Affordable Modification Program (HMP)*.

http://www.floridasupremecourt.org/pub_info/documents/AOSC09-54_Foreclosures.pdf.

legislatures have enacted forms of conference and mediation requirements for foreclosure cases, with varying degrees of court involvement.²⁰

All of these programs, including the Rhode Island and New York Bankruptcy Courts' Loss Mitigation Programs, have several features in common. They are designed to bridge the communication gap between loan servicers and homeowners, a gap that has often been cited as the major obstacle to effective loss mitigation. The programs require active participation by a representative of the servicer with full authority to consider all loss mitigation options. They regulate production of documents and facilitate some form of meeting between the homeowner and servicer, either in person or by phone. The courts play a role in supervising and, when necessary, intervening to move the process along. The programs do not require servicers or lenders to implement a particular loss mitigation option. In the bankruptcy context, these programs importantly do not compel a modification of the mortgage creditor's claim and therefore are not in violation of section 1322(b)(2) of the Bankruptcy Code.²¹ Instead, they set a standard for transparency and accountability in the foreclosure process that is often lacking without this intervention. The Rhode Island and New York Bankruptcy Courts' Loss Mitigation Programs have all of these attributes and function with procedures modeled after many similar programs in effect in courts around the country.

Bankruptcy Court Mediation Programs Can Make a Difference

²⁰ California (Cal. Civ. Code § 2923.5 and §§ 2923.52-53); Maryland (2010 House Bill 472 (Chapter 485); Michigan (2009 Enrolled Bills 4453, 4454, 4455); Nevada (2009 Enacted Assembly Bill 149); Oregon (Enrolled Senate Bill 628).

²¹ See *In re Simarra*, 2010 WL 2144150 (Bankr. D.R.I. April 14, 2010).

Bankruptcy courts can play an important role in avoiding unnecessary foreclosures and facilitating mortgage modifications through implementation of LMPs. In many respects, bankruptcy courts are ideally suited to facilitate mortgage modifications through implementation of mediation programs such as those in Rhode Island and New York. These reasons include:

1. Breaking Through Servicer Roadblocks. Homeowners routinely encounter numerous bureaucratic barriers in attempting to obtain HAMP modifications. Homeowners are repeatedly asked to provide documents because they are lost by servicers.²² The testimony given by a Rhode Island homeowner at a recent Senate subcommittee hearing conducted by Senator Whitehouse, about his quest to obtain a mortgage modification, is not uncommon.²³ After providing all required documentation to complete his application for a HAMP modification, he was repeatedly asked over a 19 month period to resubmit the same documentation to his mortgage servicer. Despite faxes, overnight deliveries, and almost weekly calls to verify that his application was complete, he received a barrage of conflicting notices from his servicer. Some stated that all documentation had been received, others noted that additional documents were needed, and several informed him that his modification request had been denied because of missing documentation. Often he was simply told to ignore the letters and foreclosure notices, and was assured that his application was being reviewed. When he finally turned

²² Peter S. Goodman, *Paper Avalanche Buries Plan to Stem Foreclosures*, N.Y. Times, June 28, 2009.

²³ See Testimony of Larry Britt, Hearing before the Senate Judiciary Subcommittee on Administrative Oversight and the Courts, October 28, 2010, available at: www.judiciary.senate.gov/pdf/10-10-28BrittTestimony.pdf.

to the HAMP Solutions Center, the organization charged by Treasury with handling disputes, he received no help, noting that “it felt like they were reading from the same script as the banks.”

Many homeowners are not able to endure these burdensome requests and long delays, and simply give up in their pursuit of a loan modifications. A growing number of homeowners facing foreclosure who are frustrated by roadblocks set up by servicers have turned to bankruptcy as a last resort for saving their homes. This has led to procedural concerns by bankruptcy courts as they struggle with how to handle hearings on chapter 13 plan confirmation and stay relief motions while a HAMP application is pending. Many trustees and judges agree that it makes no sense to proceed with these hearings without first having a decision on the modification request, but they are nevertheless mindful of court docket concerns.

The New York and Rhode Island LMPs address this problem by requiring the debtor and servicer to designate contact persons for the exchange of information. Importantly, the LMPs provide for the entry of a Loss Mitigation Order which specifies time deadlines for requests of information by the servicer and responses by the debtor. If a servicer makes unjustified and duplicative requests for information, the debtor’s attorney can seek compliance with the Loss Mitigation Order. Likewise, a servicer can seek to end the process if the debtor does not comply with valid document requests, or a servicer may object to the entry of the Order itself if, for example, the request has been made in bad faith.

2. Getting a Timely Answer. Too often homeowners wait for over a year to get a decision on a HAMP modification request. One survey found that the average

length of time homeowners spend seeking a HAMP loan modification is 14 months.²⁴ Long delays exist with respect to both decisions on eligibility for trial modifications as well as for permanent modifications. These delays occur despite HAMP guidelines which require servicers to render a decision on a completed HAMP application within 30 calendar days.²⁵ More troubling than this paralysis in rendering a decision is that homeowners may simply never get a decision at all on a HAMP modification, and are instead offered a “proprietary” modification on less favorable terms than HAMP.

The advantage of mediation programs is that they require that each of the participating parties designate a person having authority to resolve the matter. For example, the New York and Rhode Island LMPs require that each party “must have a designated person with full settlement authority present during the loss mitigation session.”²⁶ The participating parties are also required to negotiate in good faith.²⁷ The Loss Mitigation Order contains a set of time deadlines, including a designation of a loss mitigation period and the dates for the filing of status and final reports. While these programs do not compel a creditor to provide a loan modification, they ensure that debtors have a fair opportunity for consideration of their HAMP applications by a decision-maker for the creditor. Unlike applications that linger for months outside this process without judicial supervision, a debtor may seek court enforcement of the Loss Mitigation Order. This is critically important for homeowners in non-judicial foreclosure states such as Rhode Island where there is no judge overseeing the foreclosure process.

²⁴ See www.propublica.org/article/homeowner-questionnaire-shows-banks-violating-govt-program-rules.

²⁵ U.S. Treasury Dept. HAMP Supplemental Directives, No. 09-07, p. 7; No. 10-01, p. 3.

²⁶ Rhode Island General Order 09-003, Appx. IX, Part VIII, subpart D.

²⁷ Rhode Island General Order 09-003, Appx. IX, Part VII, subpart A; New York General Order M-413, Part VII, subpart A.

The LMPs also provide that at anytime in the process, the parties may request that the court appoint an independent mediator. The experience under the New York and Rhode Island LMPs is that there have been very few requests for mediation. It may be that simply providing a structured forum for the parties (who have settlement authority) to communicate is all that is needed to break the deadlock in getting a HAMP decision. Another factor may be that most debtors in bankruptcy are represented by counsel, who can assist in navigating through the HAMP program requirements. Homeowners in state foreclosure proceedings are not so fortunate. For example, 63% of the homeowners in the New York state court system attended foreclosure mediation conferences without an attorney.²⁸

3. Providing Basic Due Process. A major failing of HAMP is that homeowners are often never told the reason their modification request has been denied. Participating mortgage servicers routinely fail to comply with Treasury Department guidelines that require notice to a borrower of the reason for rejecting a HAMP application. Servicers frequently do not offer homeowners the opportunity for a review of HAMP denial decisions. The Congressional Oversight Panel noted in its April 2010 Report that servicers were reporting reasons for only 31% of disqualified or cancelled HAMP modifications.²⁹ Much of the data the servicers did report was plainly erroneous.

²⁸ State of New York Unified Court System, 2010 Report of the Chief Administrator of the Courts.

²⁹ Congressional Oversight Panel: *Evaluating Progress of TARP Foreclosure Mitigation Programs* (April 14, 2010); see also U.S. Government Accountability Office, *Troubled Asset Relief Program, Further Actions Needed to Fully and Equitably Implement Foreclosure Mitigation Programs* GAO 10-634 (June 2010); *Factors Affecting Implementation of the Home Affordable Modification Program* (March 25, 2010); and U.S. Government Accountability Office: *Troubled Asset Relief Program Home*

For 71% of denials, servicers gave no valid reason. For modification cancellations servicers provided no reason in 72% of cases.³⁰

Under the Rhode Island and New York loss mitigation programs, a servicer who wishes to terminate negotiations for cause must state the reasons for this request in filing with the court. In addition, the parties must file status and final reports indicating the progress and outcome of the negotiations. These procedures encourage transparency in the decision-making process and provide an opportunity for homeowners to obtain information that has thus far eluded homeowners and is required to be provided under HAMP.

4. Providing Protection from Foreclosure. HAMP participating servicers are under contractual obligations to consider homeowners for an affordable loan modification before they foreclose. They are required to consider a debtor in an active bankruptcy case for HAMP if a request is made by the debtor, debtor's counsel, or the case trustee.³¹ If a homeowner is found eligible under the HAMP program guidelines and placed on a trial plan, servicers must stop the foreclosure and implement the loan modification.³² However, the HAMP guidelines do not provide this same protection for homeowners while their application is under consideration. Because the foreclosure units

Affordable Modification Program Continues to Face Implementation Challenges (March 2010).

³⁰ COP Report, p. 54. The COP Report goes on to state: "[T]he panel is deeply concerned about the unacceptable quality of the denial and cancellation reasons and strongly urges Treasury to take swift action to ensure that homeowners are not denied the opportunity for a modification and shuffled off to foreclosure without a servicer at least accounting for why the modification was denied or cancelled." Among the Panel's specific recommendations in April 2010 were that Treasury impose "meaningful monetary penalties for non-compliance" with the requirement to refrain from foreclosure until the required review is completed.

³¹ U.S. Treasury Dept. HAMP Supplemental Directive. No. 10-02, p. 7.

³² U.S. Treasury Dept. HAMP Supplemental Directive. No. 09-01, pp. 6, 2.

within a servicer operation (and the law firms that handle the foreclosures) often do not communicate with the loss mitigation units handling modification requests, this “dual-track” system has resulted in a number of homeowners being foreclosed while their applications have been pending, only to be told after the sale that they were eligible for a modification.

Bankruptcy Courts’ mediation programs can fulfill a much needed role in ensuring that foreclosures do not proceed without consideration of alternatives if requested by the parties. The automatic stay under section 362 of the Bankruptcy Code protects the homeowner at least until the settlement negotiations can be concluded. If a stay relief motion is filed by the creditor, the LMP provides that any continuances will be made in accordance with Bankruptcy Code section 362(e).³³

5. Avoiding “Robo-Signer” Abuses by Servicers. There has been considerable press coverage in recent months concerning servicer abuses in the filing of false affidavits in foreclosure court proceedings. These affidavits are presented to verify the amounts owed on the mortgage debt and to confirm that the party filing the foreclosure action has standing and is the real party in interest as the holder and owner of the mortgage and note. Depositions in state foreclosure actions have revealed that these “robo-signers” often sign hundreds of affidavits per day attesting to facts not within their personal knowledge, and that the affidavits have not been properly notarized.

This problem is not new to bankruptcy courts. Long before the recent press coverage involving state court proceedings, bankruptcy courts have exposed false affidavit abuses in proceedings often brought by consumer bankruptcy attorneys and

³³ Rhode Island General Order 09-003, Appx. IX, Part VI, subpart B; New York General Order M-413, Part VI, subpart C.

judges in these cases have taken appropriate action in response.³⁴ If there are concerns that a loan modification may be entered into by a servicer who does not have authority to

³⁴ See, e.g., *In re Lee*, 408 B.R. 893 (Bankr. C.D. Cal. 2009) (Rule 9011 sanctions imposed on creditor's attorney for failure to disclose transfer of ownership of note, failure to join true owner in motion for relief from bankruptcy stay, and for submitting copy of note with motion that was not true and correct copy of the original note); *In re Taylor*, 407 B.R. 618 (Bankr.E.D.Pa. 2009) (local law firm violated Rule 9011 by allowing its attorneys to sign off on electronic filings for stay relief motions prepared by non-attorneys working with national computer data base; finding that proofs of claim filed by national firm were prepared by clerks who are not legally trained and are not paralegals, and that attorney for firm reviews only a random sample of 10 per cent of filed claims), *rev'd*, 2010 WL 624909 (E.D. Pa. Feb. 18, 2010) (setting aside bankruptcy court's findings of Rule 9011 violations by specific local counsel, but noting concerns about wider LPS practices that were the subject of lengthy critical analysis by bankruptcy court); *In re Cabrera-Mejia*, 402 B.R. 335 (Bankr. C.D. Cal. 2008) (sanctioning law firm under Rule 9011 and Bankr. Rule 105(a) after it filed twenty-one motions for relief from stay with the court without factual investigation and without properly authenticated documents to support claims). *In re Haque*, 395 B.R. 799 (Bankr. S.D. Fla. 2008) (law firm Florida Default Law Group and creditor Wells Fargo jointly and severally sanctioned \$95,130.45 for filing 45 false affidavits related to stay relief motions in which a bogus "penalty interest" fee was charged to debtors); *In re Prevo*, 394 B.R. 847, 851 (Bankr. S.D. Tex. 2008) (reviewing servicers' practices of inflating proofs of claim with undocumented and excessive fees, court concludes, "[b]ased upon hearings in this and other cases, the Court believes that certain members of the mortgage industry are intentionally attempting to game the system by requesting undocumented and potentially excessive fees and then reducing those fees in amended proofs of claim only after being exposed by debtor's counsel."); *In re Stewart*, 391 B.R. 327, 346 (Bankr. E.D. La. 2008) (servicer falsely represented BPO as pass through of a charge of between \$90 and \$125, when it actually paid \$50 for each inspection; servicer also improperly compounded late fees to charge \$360.23 over thirteen months for one \$554.11 missed payment); *In re Parsley*, 384 B.R. 138 (Bankr. S.D. Tex. 2008) (inaccuracies regarding account arrears alleged in motion not detected in part because national default service firm's engagement letter with local law firm specifically prohibited any communication between local firm and its client, the mortgage servicer); *In re Osborne*, 375 B.R. 216 (Bankr. M.D. La. 2007) (attorney sanctioned for filing affidavit alleging debtor defaulted on agreement despite attorney's lack of personal knowledge); *In re Ulmer*, 363 B.R. 777 (Bankr. D.S.C. 2007) (awarding \$33,500 in sanctions and finding that affidavits of default related to motions for relief from stay prepared by out-of-state paralegals were not executed before a notary public and may not have been reviewed and signed by attorney whose signature appeared on the affidavits); *In re Rivera*, 342 B.R. 435 (Bankr. D.N.J. 2006) (\$125,000 sanctions imposed on foreclosure law firm for filing default affidavits in 250 stay relief motions using "blanks" that were pre-signed by employee who no longer worked for servicer), *aff'd*, 2007 WL 1946656 (D.N.J. June 29, 2007); *In re Porcheddu*, 338 B.R.

act on behalf of the true owner of the mortgage, or if the homeowner contends that the unpaid amount of the debt listed in the loan modification agreement includes fees and charges not permitted by the mortgage documents or state law, these matters can be resolved by the bankruptcy court as part of the claims allowance process under sections 501 and 502 of the Bankruptcy Code.

6. Ensuring Proper Review of Modification Agreement. More troubling than servicer paralysis in rendering decisions on HAMP applications is that homeowners may simply never get a decision at all, and are instead offered some “proprietary” workout on less favorable terms than HAMP. For the first three quarters of 2010, only 30 per cent of modifications by servicers were completed under HAMP.³⁵ It is not at all certain that the 70 per cent of homeowners receiving non-HAMP modifications were properly evaluated for HAMP before a proprietary modification was offered, as required by Treasury guidelines. What is clear, based on the analysis of the Congressional Oversight Panel, is that HAMP provides a “modification offering more relief to the borrower and having a lower likelihood of redefault” than a non-HAMP modification.³⁶

In an LMP, any loan modification or other settlement reached by the parties will be submitted to the court for approval. The debtor’s counsel, chapter 13 trustee, and the

729 (Bankr. S.D. Tex. 2006) (foreclosure law firm sanctioned for filing false fee applications and misrepresenting that fee statements were based on contemporaneous time records); *In re Brown*, 319 B.R. 876 (Bankr. N.D. Ill. 2005) (\$10,000 sanction imposed on national mortgage servicer for groundless stay relief motion based on false motion); *In re Gorshtein*, 285 B.R. 118 (Bankr. S.D.N.Y. 2002)(sanctions imposed on mortgage creditors and their attorneys for filing motions for stay relief based upon false certifications that debtors had failed to make postpetition payments).

³⁵ HOPE NOW Alliance, *Industry Extrapolations and Metrics* (November 2010), p. 4.

³⁶ Congressional Oversight Panel, *December Oversight Report, A Review of Treasury’s Foreclosure Prevention Programs*, Dec. 14, 2010, p. 34.

court thus have an opportunity to consider whether the debtor was properly evaluated for HAMP and other programs, and whether the agreement is in the debtor's best interest.

7. Dealing with Second Mortgages. A major impediment to loan modifications has been the existence of secondary mortgage loans. Treasury estimates that up to 50 percent of at-risk mortgages have second liens.³⁷ Many servicers are reluctant to modify a first mortgage if the second mortgage holder does not consent or agree to subordinate its mortgage, and second mortgage holders have not been willing to cooperate. HAMP has recently attempted to address this problem through its Second Lien Program, but it is unclear whether it will overcome barriers to participation by second lien holders and thus far there have been very few participants.

Loan modifications facilitated in a bankruptcy court LMP resolve this problem because all of the liens on the property can be provided for in the debtor's chapter 13 plan based on a uniform set of laws and valuation standards. If the amount of the senior mortgages on the property exceeds the value of the home, any "underwater" junior mortgages can be voided or "stripped off" and treated as an unsecured debt under the debtor's plan. More than 76 percent of first mortgages in permanent HAMP modifications have a negative loan-to-value ratio.³⁸ Thus, many homeowners seeking HAMP modifications would be able to provide for junior mortgages by making affordable payments on them in a chapter 13 plan, thereby permitting a modification of the first lien over the objection of junior mortgage holders.

8. Dealing with the Homeowner's Entire Debt Load. Finally, another problem not addressed by HAMP is that many homeowners are burdened with debt other

³⁷ See Dept. of Treasury Making Home Affordable Program Update, April 29, 2009.

³⁸ COP December Oversight Report, *supra* note 36, p. 28.

than their home mortgages. Unable to refinance their homes, many homeowners are struggling to pay off credit card, medical bills, and other non-mortgage debt. This problem is made more acute by the current unemployment situation, with many homeowners experiencing a loss or reduction in family income. A recent Treasury report shows that after receiving a HAMP loan modification, homeowners on average still have a back-end debt-to-income ratio of 62.4 per cent.³⁹ A Congressional Oversight Panel report states that one-third of HAMP permanent modifications have back-end DTI ratios of more than 80 per cent.⁴⁰ While HAMP requires borrowers whose back-end DTI is 55 percent or greater to obtain credit counseling, there is no plan to directly assist homeowners in dealing with unmanageable debt.

Loan modifications made during a bankruptcy proceeding address this problem because all of the family's financial problems are dealt with under the supervision of a court approved Chapter 13 plan or discharged in a Chapter 7 case. In this way homeowners are far more likely to avoid default on a mortgage modification.

Results So Far Are Promising

From November 1, 2009 through December 31, 2010, loss mitigation requests were filed in approximately 11.8 per cent of the cases filed in Rhode Island during that period (chapter 7 debtors are also permitted to request loss mitigation). Of those cases that have completed the loss mitigation mediation process, approximately 35 per cent

³⁹The back-end DTI is the ratio of total monthly debt payments (including mortgage principal and interest, taxes, insurance, homeowners association and/or condo fees, plus payments on installment debts, junior liens, alimony, car lease payments and investment property payments) to monthly gross income. See November 2010 HAMP Servicer Performance Report, www.treasury.gov/initiatives/financial-stability/results/MHA-Reports/Documents/Nov%.

⁴⁰COP December Oversight Report, *supra* note 20, p. 102.

have resulted in a successful approved loan modification.⁴¹ Similar results have been obtained under the New York LMP. For many of these participating debtors, it is likely they would not have obtained modifications if the LMP had not been in place. Moreover, the number of modifications attained should not be the only goal of LMPs. Providing for a fair and transparent process, judicial efficiency, and speedy outcomes are other measures of success. Importantly, those that complete the LMP process now have a decision upon which they may move on with further proceedings in their cases, and ultimately their lives, even if that may involve a plan to sell or surrender the property.

Conclusion

To help facilitate the adoption of bankruptcy court mediation and loss mitigation programs, we would welcome the opportunity to discuss with the Committee the following recommendations:

1. Clarifying Bankruptcy Code Amendment. We firmly believe that bankruptcy courts currently possess authority to adopt mediation and loss mitigation programs under section 105(d) of the Bankruptcy Code, Bankruptcy Rule 7016, and the inherent authority of the courts themselves. The Bankruptcy Court for the District of Rhode Island just recently issued a decision rejecting a challenge to the Rhode Island LMP and finding that such authority does in fact exist.⁴²

However, to avoid unnecessary litigation such as in Rhode Island and to address any uncertainty and hesitation on the part of local courts to adopt such programs, Congress should consider enacting a clarifying amendment to section 105(d) of the

⁴¹ This slightly undercounts the success rate as 7 cases had more than one approved modification agreement.

⁴² *In re Sosa*, --- B.R. ----, 2011 WL 258673 (Bankr. D.R.I. Jan. 28, 2011).

Bankruptcy Code making clear that the courts have authority to set up programs. This would be similar to what was done in 1994 when Congress added subsection (d) to section 105 in order to clarify that the full range of settlement and conference procedures authorized under F.R. Civ. P. 16 are available in bankruptcy cases.

We understand that Senator Whitehouse is planning to introduce a bill that would amend section 105 in this manner. We believe that this proposed legislation would provide a great benefit to consumer debtors and the bankruptcy system.

2. Promotion by the Executive Office of the United States Trustees. We believe that the Executive Office of the United States Trustees should take an active role in encouraging local bankruptcy courts to adopt mediation and loss mitigation programs. The EOUST should prepare and make available model local rules or standing orders to implement such programs that courts may use, perhaps based on those already issued by the New York and Rhode Island courts. The EOUST should also release a memorandum which sets forth the legal authority bankruptcy courts have for adopting such programs. Finally, the EOUST can enlist the cooperation of Chapter 7 and 13 trustees in setting up such programs and provide them with materials and training support for their participation in mediation programs. All of these actions are within the EOUST's stated mission of promoting the integrity and efficiency of the bankruptcy system.