

"Foreclosure Workouts"

Course REL0344

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The Judicial Title Insurance Agency LLC

YOUR TITLE EXPERTS

FORECLOSURE WORKOUTS

By

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I. MY BACKGROUND

In 1991, at the age of 30, I found myself facing foreclosure. I was nine months behind on my mortgage, the bill collectors were calling day and night, and I saw no way out. At the time, the value of my home had fallen to \$185,000.00, which was \$65,000.00 less than the \$250,000.00 that I owed. In an attempt to avoid foreclosure, I was able to negotiate a settlement with my first and second mortgages, whereby the home was sold and all of my closing costs were paid (including my I.R.S. debt). Most importantly, I was able to get the bank to forgive the \$65,000.00 in remaining monies that were owed to them. That experience brought about the birth of my foreclosure workout business.

This is my story...

In 1986, I obtained my realtor's license and began to sell vacant land to builders and developers. The market was hot and, at 27 years old, I was making a six figure income. I subsequently purchased a luxury condominium in Yorktown Heights, complete with 2 fireplaces (one in the bedroom), a Jacuzzi, and a greenhouse window in the kitchen. The unit cost \$265,000, and I financed \$195,000. Unfortunately, right after I closed on my property, the stock market crashed. This had a ripple effect in the real estate market and within a year, the building boom came to a screeching halt. Unfortunately, so too did the demand for vacant land.

My income began to dry up, but my expenses seemed to be going the other way and continued to escalate. I started to live off credit cards and credit lines in order to maintain my expenses, including my mortgage. I took out an equity loan from my condominium, which pushed my total outstanding mortgage to around

\$250,000. The funds from the loan were quickly absorbed on bills, and I soon fell behind on my mortgage obligations.

In an attempt to avoid foreclosure, I listed my condominium for sale with a realtor. After nine months of missed mortgage payments and numerous threatening default letters about a pending foreclosure, my realtor finally brought me a buyer who was willing to pay \$185,000. This offer was much less than what I owed the banks. However, I was able to negotiate a deal with my lenders whereby they would accept the net proceeds from the sale as a full settlement of my outstanding debt. In other words, **I was forgiven approximately \$65,000.00 in debt, and I was able to avoid foreclosure. My credit report showed that the loans were settled.**

A business was born...

As a result of that experience, I started a business under the name of Source Properties, Inc., which specialized in assisting those who are either facing foreclosure or perhaps going that way in the near future. Since then, I have completed hundreds of workout transactions. My story has been published in numerous newspaper articles, and I have been interviewed on local radio shows.

My story continues...

In 2000, I attended to Pace Law School at night and graduated *cum laude* in 2003. I was admitted to the New York and Connecticut Bars, and opened up my own general practice law firm in Carmel, New York. I currently handle real estate, wills, matrimonial, adoptions, litigation, bankruptcy, and other various types of cases.

Around the summer of 2006, I began to receive calls again from people who were facing foreclosure. Realtors with whom I had previously worked, remembered my name, looked me up, and asked if I would still be willing to help their clients. Presently, my office is quite busy assisting these clients who are about to lose everything. Ironically, I have come full circle and once again, I am

performing workouts. In some cases, I am additionally filing Bankruptcies on my clients' behalf.

II. SOME FREQUENTLY ASKED QUESTIONS ABOUT FORECLOSURE AND BANKRUPTCY

1. **What is meant by a Note and Mortgage?** When a bank lends money on real estate, they will typically have the borrower sign a mortgage and a note in case the payments are not made. The Note is essentially a personal guarantee by the borrower to the bank that the payments will be made. If they are not made, the bank can go after the borrower's personal assets or income. The mortgage is the lender's security interest in the real estate. If payments are not made as promised by the borrower, the bank can foreclose or force a sale of the real estate in order to obtain the monies that they are owed.

2. **What is Foreclosure?** Foreclosure is a judicial process that banks can use in order to force a sale of real estate that they have a mortgage on when the borrower has defaulted on his payments. While the legal procedure is different for each state, in New York, the process is highly regulated by the courts and can only be followed if a borrower does not make his mortgage payments. Typically, a bank will not even start the legal foreclosure process until at least two to three payments are missed. The process in New York typically takes eight to twelve months from the start of the foreclosure action to the time when the bank can begin to sell the home. However, the borrower has the right to pay off the mortgage and redeem his property anytime prior to the foreclosure sale.

3. **What is a Deficiency Judgment?** If a property is sold by the bank at foreclosure and the sale proceeds do not fully pay off the outstanding mortgage and fees, the bank can obtain a deficiency judgment against the borrower. The bank must go back to court and prove that there are still monies due to them. If the statute of limitations has not run out (ninety days from the date of the sale), and the court concurs with the bank, a judgment will be issued. The judgment is valid for ten years, and can be renewed for another ten years. Any property or wages that the borrower obtains in the future is susceptible to the judgment.

4. **How can I prevent Foreclosure and Deficiency Judgments?** One option that is available to prevent a foreclosure or deficiency judgment is called a foreclosure workout. If a person is behind in his or her mortgage payments, has no assets, and the

property value is below the mortgage balance, he or she can do a foreclosure workout. This is a process whereby, the property is sold at whatever price the market will bear and a deal is made with the bank to accept the proceeds of the sale as full settlement of the note and mortgage. This will avoid foreclosure and prevent the bank from obtaining a deficiency judgment against the borrower.

5. **Can any measures be taken if the client wants to keep his home but has fallen far behind on his payments?** Oftentimes, people will undergo a difficult time whereby they lose a job, contract a serious illness, or experience marital problems which can result in long periods of missed mortgage payments. Although these people can probably afford to resume their regular monthly payments once the crisis is over, they are unable to catch up with the large amount of arrears. In order to prevent foreclosure, the banks will typically work out deals with the borrower. Two such arrangements are described below:

(a) **Forbearance Agreement** - sometimes the banks will structure a forbearance agreement whereby the borrower is allowed to pay the arrears in payments along with her regular monthly mortgage. Forbearance agreements are typically made over an eighteen to thirty-six month period.

(b) **Re-modification Agreement** - here, the bank will take all of the arrears owed, add them to the mortgage balance, and make a new mortgage. Thus, the borrower will have a new loan, which includes all of the monies owed stretched over a thirty year period with a new interest rate. Frequently, the payment on the re-modified mortgage will be at, or below, the monthly payments the borrower had on the original loan.

6. **What can be done if the bank refuses to negotiate?** If the bank either refuses to negotiate, or the deal they offer is not acceptable, there are still some options that are available. Although the client will probably want to avoid bankruptcy, it may be a necessary tool to prevent the loss of his home or to deflect a deficiency judgment against him.

III. CHAPTER 7 & CHAPTER 13 BANKRUPTCY DEFINED

1. **Chapter 7 Bankruptcy.** Chapter 7 Bankruptcy involves the liquidation of one's non-exempt assets in order to pay back as much debt owed as possible. Any debts that are not paid back from the liquidation, including deficiency judgments will be discharged. Typically, a debtor who has no assets will end up with what is called a Liquidating 7, where all debts are liquidated. A debtor can re-affirm or keep paying certain debts, such as a mortgage or a car loan, if there is no equity in the asset and the payments are current.

2. **Chapter 13 Bankruptcy.** Chapter 13 Bankruptcy is typically utilized when a debtor has assets (such as a home) that he wants to keep, but he is either behind on the mortgage payments or his asset has equity. The court will structure a monthly payment plan based on the client's amounts of equity and his outstanding debt. Although a three-year plan is allowed by code, the court can approve a plan for a five-year period based on each individual situation.

IV. PROCEDURES IN BANKRUPTCY FILING

The following steps are an integral part of the Bankruptcy process:

1. **Credit Counseling.** Prior to filing for Bankruptcy, the client must take an approved Credit Counseling Course and provide his or her attorney with a Credit Counseling certificate. The course takes about an hour, costs around \$50.00, and can be taken via phone or on-line.

2. **Filing.** During the intake session, the attorney enters the client's information into its proper format via computer. It is then reviewed for errors and subsequently filed with the court. All bankruptcy filings in the Southern District of New York (i.e., Westchester, Putnam, Rockland, Orange and Dutchess Counties) are now filed electronically via the Internet. The electronic filing provides the client with instant relief from harassing creditors, because once the filing is completed, an automatic stay is instituted for all collection efforts. The court will then send a letter to each creditor notifying them about the bankruptcy, and alerting them that the stay is in effect. After filing, a hard copy version of the form will be

printed and must then be signed by the client. Once completed, the signed form will be kept in the client's file and a copy is sent to the Bankruptcy Trustee.

3. **341 Meeting.** The court will send a notice to all interested parties once the 341 Creditor's meeting has been scheduled. Upon notification, the attorney must confirm the receipt of the notice, and inform the client that he or she will need to attend the meeting. In simple bankruptcy cases, the creditor meetings are quite uneventful and do not last more than three to five minutes. Usually, the creditors do not attend these meetings and the Trustee speaks to both the client and the attorney about the case. Once the Trustee ascertains that the filing is legitimate and there are no non-exempt assets for the estate, he or she will end the meeting. The attorney should then inform the client that in approximately ninety days, he will receive a discharge of all of his dischargeable debts that were not reaffirmed. Until that time, the automatic stay is still in effect, and the creditors are still stayed from attempting to collect their debts from the client.

4. **Financial Management Course.** In order to receive a discharge, the client must take an approved Financial Management Course and provide his or her attorney with a Financial Management Certificate. The Course can be taken via the same avenue through which the Credit Counseling Course was taken. Those clients filing for Chapter 7 must complete the Financial Management Course within forty-five days after the first scheduled 341 Meeting. Chapter 13 filers must complete the course prior to making all of their scheduled plan payments.

5. **The Discharge.** In Chapter 7 cases, the court will issue a discharge of the bankruptcy within approximately ninety days after the 341 meeting. This means that the client is no longer financially responsible for any of the debts scheduled on the bankruptcy filing. The court will issue a discharge letter with final decree and send a copy to all parties involved, including the creditors. Once the office receives the discharge with final decree, a copy will be sent to the client with an explanation of what the discharge actually means.

Chapter 13 debtors will receive a discharge at the completion of their plan, which can be anywhere from thirty-six to sixty months from the first payment. It should be noted that these cases will involve more meeting time in order to determine an acceptable plan and to properly execute it. This also entails an

additional court appearance, called a Confirmation Hearing. Therefore, legal fees should be structured accordingly to reflect the extra time needed.

6. **A Final Word About Bankruptcy.** After filing numerous bankruptcies, I have come to realize that the process is incredibly stressful and traumatic for most clients and their families. As a result, I always try to make the experience a little less mysterious and to allow my clients the opportunity to endure the process with support and empathy. Above all, I strive to find a way to help my clients weather this most difficult time, while allowing them to keep his dignity intact.

V. **IS YOUR CLIENT FACING FORECLOSURE?**

Short Sales Can Provide a Viable Solution

Many people are experiencing severe financial problems as a result of divorce, illness, job loss, or poor money management. If these people cannot become current on the mortgage, or work out an alternative settlement with the bank, they will eventually lose their property through the foreclosure process.

There are alternatives to foreclosure, and the attorney can be the vehicle by which a viable solution is offered. If a property is worth less than what is owed, and the homeowner has a legitimate hardship, a *short sale* may be an option. This is a process whereby the property is sold at or below market value, the closing costs are deducted, and the bank is given the net proceeds as a full settlement. In other words, the homeowner will not have to compensate the bank for the remaining balance. Upon completion of the transaction, the lending institution will then discontinue the foreclosure action, and will report the loan as either a settled account or as settled less than full. It is a way for clients to avoid both foreclosure and bankruptcy. In most cases, they do not even have to bring their checkbook to the closing table.

VI. THE SHORT SALE PROCESS

The short sale process can be initiated at almost any stage of the foreclosure proceedings, but it becomes exceedingly difficult as the foreclosure sale date approaches. The following is a step-by-step synopsis of the short sales process that an attorney must undertake:

1. Qualifying the client. It is incumbent upon the attorney to first qualify the client as a short sale candidate through a careful screening process. By determining immediately whether this avenue is a viable solution, the attorney saves valuable time and avoids over-inflating the hopes of the person in need. In that regard, the individual must meet the following criteria, which have been set forth by most lenders that I have dealt with over the years:

(a) The client must have a hardship that puts him in a position whereby he can no longer make his mortgage payments. Typical hardship situations include, but are not limited to: loss of job, divorce, medical problems, unexpected expenses and job relocation.

(b) The client must be in a situation whereby his expenses exceed his income, which results in an inability to make his mortgage payments.

(c) The client must be behind on his mortgage payments (typically by at least ninety days).

(d) He must be insolvent (assets are less than liabilities).

(e) The value of the property must be below what is owed to the bank.

It is important to remember, however, that before dismissing a prospective client for failure to meet the criteria, the attorney should not take the individual's answers at face value. Oftentimes, deeper probing will reveal more intricate problems that can be used to justify a short sale. In any event, the attorney may be required to find some creative alternatives and will have to hone his negotiation skills. I have included some anecdotal examples below.

2. What happens when a client says he doesn't have a hardship, but he seems to meet the other criteria? If there is truly no hardship, the bank will not help the borrower, because the banks believe that there are too many other people who really need their help. However, many times, I have discovered that by questioning the client in great detail, a hardship may be uncovered that the client had not really considered. For example, I recently met with a young woman who purchased an investment property in a depressed neighborhood. She had not carefully researched the area prior to her purchase, and when she discovered the true nature of the area, she was too frightened to live in the house. Instead, she chose to continue to live with her parents. At first impression, it seemed as if she was merely experiencing buyer's remorse after purchasing the house, and decided to stop making the mortgage payments without sufficient reason.

However, upon further questioning, I discovered that she had tried to rent out the home, but the tenants alternately would not pay her, or they would trash the house. Neighborhood drug dealers and vandals then began to break into the empty home and use it for a hang-out. Broken windows and citations from the local municipality became a regular occurrence. All of those additional expenses, coupled with the lack of rental income, made it impossible for this client to pay her mortgage.

Once I had obtained this background information, I was then able to use it as justification of a hardship for her. Had I not questioned further, I would have sent her away without hope.

3. What if the client states that his expenses do not exceed his income? If a borrower has adequate income to pay his expenses, including the subject mortgage payments, the bank will not entertain the possibility of a short sale. However, many times, the client does not properly analyze his financial situation, and a more in-depth investigation is needed to determine whether he is a candidate. For example, I have a client who recently split up with her husband and moved back home with her mother. She is working and has a good salary. During our initial interview, it to me appeared that even without her husband's financial assistance, she could make the mortgage payments on the empty house, because she was living rent-free with her mother.

However, upon further investigation, I ascertained that she was giving her mother money to help with the household supplies, food, utilities, etc. Furthermore, she revealed that she would not be staying with her mother indefinitely. I thought that perhaps an allowance could be made for rental payments, which would be required by her in the near future. In this light, my

client's expenses really did exceed her income, and she may very well qualify for a short sale.

4. **What happens when the client's expenses exceed his income, but he is current in his mortgage payments?** If a borrower is current in his mortgage payments, the bank will not help him *even if his expenses exceed his income*. Many times, clients are in a situation whereby their expenses exceed their income, but they remain current in their mortgage payments by draining savings, accessing credit lines, borrowing from friends or relatives, or even borrowing from retirement accounts. In those situations, I advise the client to ***stop making mortgage payments***. I do this with confidence, because I believe that a borrower whose expenses exceed his income has ***no obligation*** to do any of the aforesaid in order to make his mortgage payments. If the client in that situation continues to make mortgage payments, eventually the source of funds will dry up and the client will find himself in a deeper hole, and may have dragged a relative or two down with him. Once a few months of non-payments have passed, I find that the banks suddenly become very responsive to negotiation.

5. **Can a short sale be performed when the client owns other real estate or assets?** If a client has assets, the bank will be in a position whereby they can foreclose on the subject property, obtain a deficiency judgment and recover the loss by going after all of the client's assets. However, just because a client has another house, that second residence may not necessarily be considered an asset. It must first be determined what the property is worth in today's market, and how much is owed. A consideration in that exercise is the Homestead Exemption, which is now valued at \$50,000.00 per person on one's primary residence. According to that exemption, even if there is \$100,000.00 worth of equity in a property that is owned by a husband and wife, a bank cannot touch that equity to collect on any deficiency judgment, and the client may qualify for a short sale.

Recently, I closed on a short sale in which my client took a job relocation offer, put his house up for sale, and moved to California. He and his wife then purchased a house in California, using a 90% mortgage. They still owned the house in New York, which they could not sell even after having it on the market for over a year. Since they could not maintain mortgage payments on both houses, they went into default on the New York house, which was worth around \$425,000. By that time, they owed approximately \$525,000.00 to two lenders. In this case, I was able to negotiate a short sale whereby the first mortgage was paid in full, and the second mortgage accepted approximately \$100,000.00 less than what they were

owed as a full settlement. My client avoided foreclosure without any further obligations to the bank, and kept his new home in California.

6. **Can a deal be made with the bank if the client has a large salary or non-exempt assets?** Even if the borrower is a high-income earner or has available resources to pay back the bank, deals can sometimes be made. I recently closed on a short sale transaction in which the clients were both working and they earn a total of \$100,000.00 per year. They also had a massive amount of debt and a number of set-backs which qualified them for the short sale. However, the loss to the bank was well over \$120,000.00, and the bank was not about to let these high-income earners walk away from this debt completely. Therefore, a deal was made whereby the bank conceded to the short sale with the stipulation that the borrowers sign a *non-interest, twenty-year, unsecured promissory note* in the amount of \$60,000.00 with payments of \$250.00 per month. The bank let my clients off the hook for the remaining \$60,000.00, and a foreclosure was avoided.

7. **Retaining the Client.** As with all legal matters, a client must be retained prior to performing any legal work which will generate a fee over \$3,000.00. When retaining a workout client, I try to obtain money *up front*, but in some cases, I will offer payment arrangements to clients who are having difficulty in coming up with the entire fee. In situations where the client cannot pay anything, I waive the initial fee altogether. The balance of the fee is paid as a legal fee by the bank, *if and when the transaction closes*. In addition to my retainer agreement, I have the client sign an authorization. This document allows my office to communicate with the bank on my client's behalf and to negotiate with the realtor as well. I have included a sample Short Sale Retainer Agreement and Authorization as Exhibit A.

8. **Initial contact with the bank.** Once the client is retained, contact should be made immediately with the bank via phone or fax. The department that typically handles workouts goes by different names, depending on the lending institution, but it is usually called the **Loss Mitigation Department**, or the **Workout Department**. It is important to get a fax number and the name of a contact person right away. Once a fax number for the correct department has been obtained, the client authorization should be faxed to them, along with a request for a financial package. It should be noted that the foreclosure process will still continue and will typically not be stopped until an acceptable deal has been submitted to the bank. See Workout Package Request Letter, attached as Exhibit B.

9. **Marketing the home.** If the property is not listed for sale, a realtor must be found who is capable and willing to handle a short sale. The property is then listed for sale, and it is imperative that the following language be included in the listing agreement: “**all deals are subject to the Seller’s Bank’s approval**”. If there are any special codes in the local MLS system regarding foreclosure situations, these codes must be utilized. If the property has already been listed for sale, make sure that the said language and MLS codes are incorporated in the listing. The aforesaid additions will protect the seller from being sued for a commission in the case where a full price offer is brought to him and his bank refuses to grant a short sale. It also protects the listing broker from being sued by another broker. The property should be priced at or slightly below market value, or near what is owed. Frequent price reductions should be taken until a realistic offer is received.

The realtor must be instructed to call the attorney with all **reasonable** offers. The attorney, in turn, must rely upon the expertise of the realtor in order to determine if an offer should be accepted. One of the big problems with short sales is the bank’s long approval process, which can typically take eight to twelve weeks. Therefore, one does not want to submit a deal to the bank that will be ultimately rejected after tying up the property for an eight-to-twelve week period of time. To that end, the attorney must depend heavily upon the realtor’s knowledge of the marketplace. The goal is to be certain that whatever price is negotiated, it will ultimately be accepted by the bank. Once a price is agreed upon, a Realtor’s Purchase Memo is drawn up and submitted to the attorney for contract preparation.

10. **Home Equity Theft Protection Act.** Any contract that is prepared for a short sale should be in compliance with the *Home Equity Theft Protection Act*. This act was designed to protect homeowners who are in foreclosure from losing equity in their homes due to unscrupulous investors. The Act came about as a result of situations where investors were offering to pay off homeowners’ mortgages that were being foreclosed upon. Those investors would loan money in exchange for the deed to the property, with the promise that the homeowner could later purchase the property back.

An example of this situation might be an elderly lady owning a \$500,000.00 Brownstone in Brooklyn, which had only a \$40,000.00 mortgage left on it. The woman’s husband had passed away, and she had fallen behind in her mortgage

payments due to the lack of her husband's income. The friendly-looking investor who reminded the elderly lady of her grandson offered hope.

He told her that he would pay off the \$40,000.00 mortgage in full, and give her an additional \$25,000.00 in cash. In order to secure this generous offer, the \$500,000.00 Brownstone would have to be deeded over to the investor, and the lady would simply pay rent to him. She would even have an option to purchase the home back within a two-year period. It seemed like a great deal - she would avoid foreclosure, acquire some spending money, have adequate funds to make her monthly expenses, and remain in her home.

Of course, the extra \$25,000.00 would not last long, especially if the compassionate lady's *real* grandchildren received word of the \$25,000.00 windfall, and then proceeded to reveal to Grandma all the details of their financial woes.

Sadly, if this elderly lady missed any rental payments, the unscrupulous investor would simply evict her, and would then own a \$500,000.00 property which was purchased for \$65,000.00!

However, the Act does not apply to situations where the property is being purchased for a primary residence. There are also numerous other situations where the Act does not apply. In fact, in a short sale transaction, there is not supposed to be any equity in the property; thus, the Act will most likely not apply. However, in order to cover all bases, there are some simple things that the attorney can do when drafting the contract in order to remain in compliance with the Act. For instance, the contract should be drafted in twelve-point bold, and contain a five-day Notice of Cancellation. I have attached a Notice of Cancellation that complies with the Act as Exhibit C.

11. Drafting the Workout Sales Contract. The Contract of Sale, incorporating the said Home Equity Theft Protection Act language and format, should be constructed based on the realtor's Memorandum of Sale. The contract should be written in a standard real property format, but must have language in it which makes it clear that **the transaction is conditional based upon the Seller's Bank's approval**. The last thing the attorney wants is for his client to be forced to sell his home at a price which is below what is owed, even if the bank is not willing to take a hit. Without that language in the contract, the attorney leaves his client open to a lawsuit involving specific performance. The following is an example of the language that the attorney can use in the workout contract in order to protect the client:

It is understood by all parties in this transaction that the total encumbrances on the subject property, plus the Seller's closing costs may exceed the purchase price of the property. It is further understood that in order to complete this transaction, the Seller's attorney must negotiate a settlement with the Seller's lending institution(s) and other creditors, whereby they will accept less than what is owed on the Seller's outstanding obligations to them. It is also understood that these negotiations may take considerable time, and there is no guarantee that they will be successful. Furthermore, there is no guarantee that the Seller will be able to complete this transaction. If the said negotiations are not successful, the Purchaser's down payment will be returned to him, and there will be no further obligations between the parties. Lastly, it is understood that the Seller's attorney is not a party to this transaction, and the Purchaser will hold him harmless in regard to any success or failure of the said negation process.

Once the contract is completed, it should be transmitted to the Purchaser's attorney, along with a request that he order the title report on a "rush basis." Title is needed in order to determine what liens and encumbrances must be negotiated in order to make the short sale process a success. This is because it is the attorney's responsibility to make certain that all mortgages, taxes, liens, judgments and other encumbrances are satisfied prior to closing.

12. Document Pre-Sign Meeting. When the contracts are returned to the attorney signed by the Purchaser, the client should be brought into the office for signing of the documents. Much can be accomplished at that meeting. The attorney should have the client bring all of the necessary documents required for the short sale such as: tax returns, pay-stubs, bank statements and other papers required by the bank. The financial statement should also be prepared by the attorney at the meeting based upon the figures provided by the client. Care must be taken in completing out this form, because the bank will rely on it to determine the financial condition of the borrower. Remember that the bank wants to confirm that the borrower's expenses are higher than his income, and that he doesn't have any viable assets.

The package must also contain a detailed Seller's hardship letter. This letter must describe: the Seller's difficulties, how his hardship occurred, and what his situation is at this moment. The attorney can assist in drafting that letter at the meeting if the client has difficulty composing it. In addition, the closing documents (Deed, TP-584, RP 5217 and P.O.A.) should be prepared prior to the meeting and signed by the client. I suggest that the closing documents be pre-signed for a number of reasons. First of all, these closings are not pleasant for the clients, and

since they are losing their homes, and they will not be receiving any funds from the closing, they are rarely motivated to attend. Pre-signing expedites the process and ensures that the documents are ready to go in case the client cannot be present. Finally, short sale clients can sometimes be difficult to reach due to family problems, depression or illness, and once the deal is approved, it must close immediately.

13. Title Review and Net Sheet Preparation. Review of the title report and preparation of the Estimated Net Proceeds sheet is one of the most critical steps in the short sale process. If the attorney misses any outstanding taxes, mortgages or obscure liens/judgments on the title, the transaction will be a disaster and may ultimately never close.

The attorney must first determine how many mortgages are on the property, and if there are any hidden liens, judgments or tax liens. Ultimately, each creditor must be satisfied in some way in order to transfer the property. In addition, it must be determined if any real estate taxes are owed. Based on the aforesaid, the attorney needs to calculate how much money is needed for each creditor and how much will be necessary to pay all of the closing expenses including the legal fee and real estate commission. If there are junior mortgages or judgments on the property, it is most likely that they will have to settle for a fraction of what is owed in order to make the deal work. In fact, I have encountered many situations where second mortgage holders took 10% or less of what they were owed in order to avoid foreclosure. This is because junior mortgages will get wiped out in a foreclosure sale that does not generate enough funds to pay the first mortgage holder. So, once I explain these facts to the second mortgage holder, I am better able to convince them that accepting something is better than receiving nothing. Once the aforesaid is determined, the attorney must prepare an estimated HUD, or Net Sheet, elaborating all of the expenses that need to be paid, including monies going to judgments and/or junior liens. The bottom line of the Estimated Net Proceeds sheet will show how much the bank will net from the short sale.

14. Workout Submission. After meeting with the client, and the contracts are fully executed, the financial package is prepared, and the Net Sheet, or HUD, is created, the complete package must then be submitted to the Seller's bank and to any junior lien holders and judgment creditors. The bank loan number must be printed on each page, and then the full package is usually sent via facsimile to the bank. It should be noted that the foreclosure process usually continues even though a short sale package is submitted to the bank. However, the

banks have become more open to stopping foreclosure sales if a viable workout proposal has been submitted to them. See Workout Submission letter, Exhibit D.

15. Project Lifeline. There is a program that has just been introduced by the Bush Administration called, "Project Lifeline". This is a voluntary program that a number of banks have joined, which freezes the foreclosure process for thirty days while the homeowner in foreclosure tries to work out a deal with his bank. This program does not apply to borrowers in bankruptcy, or where a foreclosure sale is already scheduled, or for vacation or investment properties.

16. Follow-up. At this time, the attorney must follow-up in order to ensure that the package was received. It is critical to make a complete duplicate of the package since, in my experience, the banks have been known to frequently lose or misplace them. Don't be surprised if the same package is requested to be shipped to the bank numerous times before someone acknowledges that it has been received. Please realize that banks are large organizations with many departments in many locations, and they have thousands of submissions coming in each week. I recommend that each call be documented, along with the date and name of the department and representative with whom you spoke.

Once the bank has received the package, the processing time will typically take eight to twelve weeks. But this does not signal a time to relax and wait. In fact, the attorney must become most diligent now, because it is critical to begin the follow-up calls with the bank on a regular basis, to ensure that the file does not get "buried." However, there must be balance in the follow-up process. On the one hand, the attorney needs to be persistent, but he must be careful not to make an enemy of the rep at the bank. Each representative is handling hundreds of files and the last thing the attorney wants is to have his file ending up at the bottom of the pile or, worse, in the shredder. I seem to get the best results by being a "nice pest".

17. The Appraisal. Once the file has been assigned to a negotiator, or workout specialist, he will order an Appraisal, or Broker's Price Opinion. This is another critical step in the process. Since the banks are typically out-of-state, they will rely heavily upon the results of the Appraisal. Remember that the banks don't trust the realtor, they don't trust the borrower, and they certainly don't trust the lawyer. But they *do* trust the appraiser. If the value of the property comes in at or below the selling price, the chances are good that the short sale will be approved. If the appraisal comes in higher than the selling price, the deal will most likely be rejected, and the bank will then demand more money for the property. There is nothing more frustrating and disappointing than going through the whole short sale

process and investing many hours of precious time and energy, only to have it go down the tubes because of a high appraisal. Remember that the discussion about the value of the property should have taken place between the realtor and the attorney early on when it was decided whether to proceed with the offer or not.

One of the problems with out-of-state banks is that they typically hire appraisers from out of the market area who may not be familiar with the local market. I find it helpful to make myself the contact person for the appraiser. This way, I can conduct a conference call between myself, the appraiser, and the realtor so that the details of the transaction and of the property condition can be discussed clearly. For instance, the appraiser might never know that the pipes of the home had all frozen up and that the furnace needed to be replaced, or that there is a toxic waste site located across the street, and that is the reason why the selling price is so low. I always request that the realtor make arrangements to meet the appraiser at the property and, as a courtesy, provide the appraiser with some comparable home sales in the area. Once the bank has completed the appraisal of the property, the negotiation process will begin.

18. Negotiation Process. This is yet another critical step, and may encompass more than one party if the mortgage has P.M.I. insurance on it. If the loan is a VA or FHA loan, the attorney should familiarize himself with the strict guidelines provided by those agencies. The negotiations may last several weeks, and will include some interfacing with the client if the bank requests any participation. If the borrower has any means to pay back some of the difference, the bank may insist on having the borrower sign a small non-interest promissory note. Make sure that all of the expenses in the HUD or Net Sheet are going to be paid by the bank before agreeing to any deals. These transactions are almost always negotiable, so the attorney should become determined during this process. If the negotiator is unwilling to negotiate, or is being unreasonable, I recommend speaking with his supervisor. If the supervisor is also inflexible, keep going to the top until contact is made with someone who is willing to listen. There have been many situations where I have doggedly gone up numerous levels of management until I found someone who was reasonable and who cared. In some cases, I was even forced to contact the NYS Banking Commission because the bank was not acting properly. However, always remember to be a “nice pest” - not an “aggressive louse.”

19. The Approval. Once an acceptable deal has been agreed upon, the bank will typically fax a Short Sale Approval Letter, or Demand Letter. Make sure that the net proceeds on the letter are what was agreed upon, and will be adequate

enough to pay all of the necessary expenses to close the transaction. In addition, always make certain that the bank is taking the net proceeds as **full settlement of the note and the mortgage**. If the bank is agreeing to release the lien only, or satisfy the mortgage only, the borrower will still be on the hook for the note. In some cases, this may be the best deal that the bank is willing to offer. Sometimes, however, if they are pushed hard enough, they will agree to satisfy the note.

Many second mortgage companies are now taking a small percentage of what they are owed as a settlement in the short sale process. However, they are not satisfying the note, which leaves the client open to a subsequent suit for judgment. Since the statute of limitations for breach of contract is six years, the client may end up being sued for a judgment by the second lien holder or its assigns many years after the transaction is closed. However, it has been my experience that the banks typically don't pursue these judgments, and even if they do, the client can always protect himself later by filing for bankruptcy. If that is the case, remember that a foreclosure was still avoided, and that if the deal had gone to foreclosure, *all* of the banks would have been able to go after the borrower for the deficiency amounts.

20. Pre-Closing. Once the approval letter is received, it must be faxed to the title company for approval. The approval letter should state that, **“upon receipt of the net proceeds, the bank will cancel the Lis Pendens, discontinue the foreclosure action, vacate the judgment of foreclosure, and satisfy the note and mortgage,”**. The attorney for the Purchaser must then be contacted so that closing can be scheduled. Make sure that the client has pre-signed the closing documents prior to the closing. Make sure also that all of the conditions in the bank's approval letter have been satisfied. Many times they will require that the HUD be approved prior to closing – sometimes up to seventy-two hours before. Be sure that the HUD follows the approval letter to the letter, and tracks the expenses submitted on the original HUD or Net Sheet. The trick is to show \$0.00 proceeds to the Seller, and have the expenses on page two equal what was approved by the bank.

21. The Closing. If the attorney was diligent and meticulous enough to work out deals with *all* of the mortgage(s), liens and back property taxes, the closing will go smoothly. This means that the attorney has already made certain that there will be adequate funds to pay all of the expenses and closing costs after the mortgage(s) and lien holders. If there are any excess funds due to prepaid taxes, they must be added to the net proceeds that the first mortgage holder had agreed to. This should result in the HUD still showing a \$0.00 balance to the

Seller. Otherwise, the closing will be conducted in quite the same way as any other real estate transaction. By being prepared, the attorney should experience a stress-free closing, which results in a positive outcome for all parties involved.

VII. THE PHANTOM TAX

Beware of the Phantom Tax. This is a obscure tax which is based upon the discharge of debt that is being considered as income. Lenders or creditors who agree to discount the amount of monies owed to them are required to issue a 1099 to the borrowers for the amount of money which was forgiven. For instance, if the original balance was \$100,000.00, and the bank agreed to accept \$10,000.00 as a full settlement, they would then issue a 1099 for \$90,000.00. So even if the borrower was unemployed that year, he would be issued a 1099 which stated that his income was \$90,000.00, and he would be required to pay income taxes on that amount.

1. **The Government to the rescue?** On October 4, 2007, the H.R. 3648 Mortgage Forgiveness Debt Relief Act of 2007 was introduced. The bill provides a permanent exclusion from income for discharge of debt for up to two million dollars of indebtedness. The Act requires that the indebtedness be secured by a *principal residence and is used for the acquisition, construction or substantial improvement of the principal residence*. Unfortunately, this Act does not cover the large percentage of borrowers facing foreclosure. This is because most borrowers had re-financed their mortgages, or taken out equity loans or second mortgages to pay back a higher interest rate loan, or pay off credit cards or bills. If the monies were not used for the purposes required by the Act, the borrower will not be shielded by the Act from having the discharge of debt count as gross income. See a more detailed description of the Act, attached hereto as Exhibit E.

2. **Section 108 saves the day.** Sec. 108 of the IRS Tax Code will save the borrowers in most cases from having discharge of debt count as gross income. This statute states that, "gross income does not include any amount which (but for this subsection) would be includable in gross income by reason of the discharge of indebtedness of the taxpayer if... the discharge occurs when the taxpayer was insolvent." The term "insolvent" refers to the excess of liabilities over fair market value of assets. Another words, the taxpayer owes more than he has. The majority

of clients who could be assisted with short sales are usually in a situation whereby they will be considered insolvent. This statute takes effect, regardless of whether the mortgage monies were used for property that was a primary residence or an investment property, and also applies to discharge of other indebtedness such as credit card debt. See Sec. 108, attached hereto as Exhibit F.

VIII. ETHICAL CONSIDERATIONS

1. Contacting another attorney's client. In this type of transaction there are a number of ethical dilemmas which should be considered. For instance, if the Seller's attorney contacts the bank directly to negotiate a short sale, then he has technically made direct contact with another attorney's client. This is because when there is an active foreclosure pending on the client's home, the bank would then be represented by an attorney who is handling that foreclosure action. Since the Seller's attorney had contacted the bank directly to negotiate a short sale, the Seller's attorney had essentially contacted another attorney's client. Therefore, he may be in violation of the ethics codes.

In order to handle this type of dilemma, the Seller's attorney should send the foreclosing attorney a letter or a Notice of Appearance detailing his plan to proceed with a short sale, and stating his desire to contact the bank directly. Most foreclosing attorneys will not object to the Seller's attorney contacting the bank directly, and the Seller's attorney has "covered his tail." See Notice to Foreclosing Attorney letter, attached hereto as Exhibit G.

2. Advising the client to stop making mortgage payments. As stated previously, if a borrower is current in his mortgage payments, the bank will not help him, even if his expenses exceed his income. This bears repeating again, because it is here that I must stress the ethical component of this course of action. While advising a client to stop making his mortgage payments can have drastic repercussions, I have had to weigh the consequences of my client continuing to pay his mortgage without adequate funds. And so it is with confidence that I advise my clients to *stop making mortgage payments*. I do this because I believe that a borrower whose expenses exceed his income has *no obligation* to do any of the aforesaid in order to make his mortgage payments. If the client in that situation continues to make mortgage payments, eventually the source of funds will dry up,

the client will have placed himself in a deeper fiscal hole, and may have dragged a friend or relative down with him.

IX. CONCLUSION

Please realize that these short sale transactions can become quite complicated, and are very time consuming. This means that time ordinarily spent on other cases may be spent on the phone chasing bankers and realtors, or negotiating with other lien holders. If you typically bill by the hour, you may be disappointed at the amount of hours spent on these deals versus the monetary compensation.

However, short sales are a wonderful way to create a win-win situation for all parties involved. The client can avoid both foreclosure and bankruptcy and, in most cases, will not have to contribute any funds to the sale. The banks, on the other hand, can cut their losses early on. Finally, the lawyer can help his clients get out of a very difficult situation, and earn a nice fee. The final Exhibit H provides a step-by-step synopsis of the short sale process, which will be helpful to instruct the realtors or other attorneys in this type of transaction.

Good luck!

Sec. 108. Income from discharge of indebtedness

TITLE 26, Subtitle A, CHAPTER 1, Subchapter B, PART III, Sec. 108.

STATUTE

(a) Exclusion from gross income

(1) In general

Gross income does not include any amount which (but for this subsection) would be includible in gross income by reason of the discharge (in whole or in part) of indebtedness of the taxpayer if -

(A) the discharge occurs in a title 11 case

(B) the discharge occurs in a case in which the taxpayer is insolvent

(C) the indebtedness discharged is qualified farm indebtedness, or

(D) in the case of a taxpayer other than a C corporation, the indebtedness discharged is qualified real property business indebtedness.

(2) Coordination of exclusions

(A) Title 11 exclusion takes precedence

Subparagraphs (B), (C), and (D) of paragraph (1) shall not apply to a discharge which occurs in a title 11 case.

(B) insolvency exclusion takes precedence over qualified farm

exclusion and qualified real property business exclusion

Subparagraphs (C) and (D) of paragraph (1) shall not apply to a discharge to the extent the taxpayer is insolvent

(C) insolvency exclusion limited to amount of insolvency

In the case of a discharge to which paragraph (1)(B) applies, the amount excluded under paragraph (1)(C) shall not exceed the amount by which the taxpayer is insolvent

(b) Reduction of tax attributes

(1) In general

The amount excluded from gross income under subparagraph (A), (B), or (C) of subsection (a)(1) shall be applied to reduce the tax attributes of the taxpayer as provided in paragraph (2).

(2) Tax attributes affected; order of reduction

Except as provided in paragraph (5), the reduction referred to in paragraph (1) shall be made in the following tax attributes in the following order:

- (A) NOL**
Any net operating loss for the taxable year of the discharge, and any net operating loss carryover to such taxable year.
- (B) General business credit**
Any carryover to or from the taxable year of a discharge of an amount for purposes for determining the amount allowable as a credit under section 38 (relating to general business credit).
- (C) Minimum tax credit**
The amount of the minimum tax credit available under section 53(b) as of the beginning of the taxable year immediately following the taxable year of the discharge.
- (D) Capital loss carryovers**
Any net capital loss for the taxable year of the discharge, and any capital loss carryover to such taxable year under section 1212.
- (E) Basis reduction**

 - (i) In general**
The basis of the property of the taxpayer.
 - (ii) Cross reference**
For provisions for making the reduction described in clause (i), see section 1017.
- (F) Passive activity loss and credit carryovers**
Any passive activity loss or credit carryover of the taxpayer under section 469(b) from the taxable year of the discharge.
- (G) Foreign tax credit carryovers**
Any carryover to or from the taxable year of the discharge for purposes of determining the amount of the credit allowable under section 27.
- (3) Amount of reduction**

 - (A) In general**
Except as provided in subparagraph (B), the reductions described in paragraph (2) shall be one dollar for each dollar excluded by subsection (a).
 - (B) Credit carryover reduction**
The reductions described in subparagraphs (B), (C), and (G) shall be 33 1/3 cents for each dollar excluded by subsection (a). The reduction described in subparagraph (F) in any passive activity credit carryover shall be 33 1/3 cents for each dollar excluded by subsection (a).
- (4) Ordering rules**

 - (A) Reductions made after determination of tax for year**
The reductions described in paragraph (2) shall be made after the determination of the tax imposed by this chapter for the taxable year of the discharge.

- (B) Reductions under subparagraph (A) or (D) of paragraph (2)**
The reductions described in subparagraph (A) or (D) of paragraph (2) (as the case may be) shall be made first in the loss for the taxable year of the discharge and then in the carryovers to such taxable year in the order of the taxable years from which each such carryover arose.
- (C) Reductions under subparagraphs (B) and (G) of paragraph (2)**
The reductions described in subparagraphs (B) and (G) of paragraph (2) shall be made in the order in which carryovers are taken into account under this chapter for the taxable year of the discharge.
- (5) Election to apply reduction first against depreciable property**

 - (A) In general**
The taxpayer may elect to apply any portion of the reduction referred to in paragraph (1) to the reduction under section 1017 of the basis of the depreciable property of the taxpayer.
 - (B) Limitation**
The amount to which an election under subparagraph (A) applies shall not exceed the aggregate adjusted bases of the depreciable property held by the taxpayer as of the beginning of the taxable year following the taxable year in which the discharge occurs.
 - (C) Other tax attributes not reduced**
Paragraph (2) shall not apply to any amount to which an election under this paragraph applies.
- (c) Treatment of discharge of qualified real property business indebtedness**

 - (1) Basis reduction**

 - (A) In general**
The amount excluded from gross income under subparagraph (D) of subsection (a)(1) shall be applied to reduce the basis of the depreciable real property of the taxpayer.
 - (B) Cross reference**
For provisions making the reduction described in subparagraph (A), see section 1017.
 - (2) Limitations**

 - (A) Indebtedness in excess of value**
The amount excluded under subparagraph (D) of subsection (a)(1) with respect to any qualified real property business indebtedness shall not exceed the excess (if any) of -

 - (i) the outstanding principal amount of such indebtedness (immediately before the discharge), over**

- (ii) the fair market value of the real property described in paragraph (3)(A) (as of such time), reduced by the outstanding principal amount of any other qualified real property business indebtedness secured by such property (as of such time).
- (B) Overall limitation
The amount excluded under subparagraph (D) of subsection (a)(1) shall not exceed the aggregate adjusted bases of depreciable real property (determined after any reductions under subsections (b) and (g)) held by the taxpayer immediately before the discharge (other than depreciable real property acquired in contemplation of such discharge).
- (3) Qualified real property business indebtedness
The term "qualified real property business indebtedness" means indebtedness which -
 - (A) was incurred or assumed by the taxpayer in connection with real property used in a trade or business and is secured by such real property,
 - (B) was incurred or assumed before January 1, 1993, or if incurred or assumed on or after such date, is qualified acquisition indebtedness, and
 - (C) with respect to which such taxpayer makes an election to have this paragraph apply. Such term shall not include qualified farm indebtedness. Indebtedness under subparagraph (B) shall include indebtedness resulting from the refinancing of indebtedness under subparagraph (B) (or this sentence), but only to the extent it does not exceed the amount of the indebtedness being refinanced.
- (4) Qualified acquisition indebtedness
For purposes of paragraph (3)(B), the term "qualified acquisition indebtedness" means, with respect to any real property described in paragraph (3)(A), indebtedness incurred or assumed to acquire, construct, reconstruct, or substantially improve such property.
- (5) Regulations
The Secretary shall issue such regulations as are necessary to carry out this subsection, including regulations preventing the abuse of this subsection through cross-collateralization or other means.
- (d) Meaning of terms; special rules relating to certain provisions
 - (1) Indebtedness of taxpayer
For purposes of this section, the term "indebtedness of the taxpayer" means any indebtedness -
 - (A) for which the taxpayer is liable, or
 - (B) subject to which the taxpayer holds property.
 - (2) Title 11 case
For purposes of this section, the term "title 11 case" means a case under title 11 of the United States Code (relating to bankruptcy), but only if the taxpayer is

under the jurisdiction of the court in such case and the discharge of indebtedness is granted by the court or is pursuant to a plan approved by the court.

(3) Insolvent

For purposes of this section, the term "insolvent" means the excess of liabilities over the fair market value of assets. With respect to any discharge, whether or not the taxpayer is insolvent, and the amount by which the taxpayer is insolvent, shall be determined on the basis of the taxpayer's assets and liabilities immediately before the discharge. [(4) Repealed. Pub. L. 99-514, title VIII, Sec. 822(b)(3)(A), Oct. 22, 1986, 100 Stat. 2373]

H.R. 3648
Mortgage Forgiveness Debt Relief
Act of 2007

October 4, 2007

Permanent exclusion from gross income of discharged home mortgage indebtedness. The bill would amend current law, which requires taxpayers to include discharges of mortgage indebtedness as income and to pay tax on this income. The bill would provide a permanent exclusion for discharges of up to two million dollars of indebtedness (on or after January 1, 2007) which is secured by a principal residence and which is incurred in the acquisition, construction, or substantial improvement of the principal residence. Instead of including this amount as income, the basis of the individual's principal residence would be reduced by the amount excluded from income under this bill. *This proposal is estimated to cost approximately \$1.4 billion over 10 years.*

Long-term extension of the deduction for mortgage insurance. The bill extends the deduction for mortgage insurance for seven years (through the end of 2014). Current law limits the deduction for mortgage insurance to payments (including Veterans Administration, Rural Housing Administration, and Federal Housing Administration insurance premiums) made prior to the end of 2007. The bill would provide that payments will qualify for this deduction whenever they are paid so long as the contract is entered into after 2006 and before 2015. *This proposal is estimated to cost \$570 million over the next 10 years.*

Modification of the qualification tests for cooperative housing corporations. The bill would modify the requirements for qualifying for the special rules available to cooperative housing corporations. Under current law, a cooperative housing corporation must meet several requirements, including a requirement that 80 percent or more of the cooperative housing corporation is earned from the corporation's tenant-stockholders. The bill would provide two alternatives to this 80 percent rule (i.e., one based on square footage and another based on cooperative expenditures). These two alternatives will make it easier to qualify as a cooperative housing corporation. *This proposal is estimated to cost \$22 million over 10 years.*

Modification of exclusion of gain on sale of a principal residence. The bill amends the current law exclusion of up to \$250,000 (\$500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. Under current law, the sale of a home will qualify for this exclusion if the home is a taxpayer's principal residence for at least two of the five years ending on the sale or exchange. This exclusion applies even if the home was initially purchased as a second home. Under the bill, if a taxpayer moves their principal residence to a second home, the taxpayer will only be able to utilize this exclusion to the extent that it relates to the period of time when the home was first used as a principal residence. The bill grandfather's use before 2008. *This proposal is estimated to raise \$2.005 billion over 10 years.*



Federal Register

Wednesday,
December 1, 2010

Part VI

Federal Trade Commission

16 CFR Part 322

Mortgage Assistance Relief Services; Final
Rule

FEDERAL TRADE COMMISSION

16 CFR Part 322

RIN 3084-AB18

Mortgage Assistance Relief Services

AGENCY: Federal Trade Commission (FTC or Commission).

ACTION: Final rule.

SUMMARY: Pursuant to the 2009 Omnibus Appropriations Act (Omnibus Appropriations Act), as clarified by the Credit Card Accountability Responsibility and Disclosure Act of 2009 (Credit CARD Act), the Commission issues a Final Rule and Statement of Basis and Purpose (SBP) concerning the practices of for-profit companies that, in exchange for a fee, offer to work on behalf of consumers to help them obtain modifications to the terms of mortgage loans or to avoid foreclosure on those loans. The Final Rule, among other things, would: prohibit providers of such mortgage assistance relief services from making false or misleading claims; mandate that providers disclose certain information about these services; bar the collection of advance fees for these services; prohibit anyone from providing substantial assistance or support to another they know or consciously avoid knowing is engaged in a violation of the Rule; and impose recordkeeping and compliance requirements.

DATES: This final rule is effective on December 29, 2010, except for § 322.5, which is effective on January 31, 2011.

ADDRESSES: Requests for copies of this Rule and this Statement of Basis and Purpose (SBP) should be sent to: Public Reference Branch, Federal Trade Commission, 600 Pennsylvania Avenue, NW., Room 130, Washington, DC 20580. The complete record of this proceeding is also available at that address. Relevant portions of the proceeding, including the Final Rule and SBP, are available at (<http://www.ftc.gov>).

FOR FURTHER INFORMATION CONTACT: Laura Sullivan or Evan Zullow, Attorneys, Division of Financial Practices, Federal Trade Commission, 600 Pennsylvania Avenue, NW., Washington, DC 20580, (202) 326-3224.

SUPPLEMENTARY INFORMATION:

I. Background

A. Statutory Authority

On March 11, 2009, President Obama signed the Omnibus Appropriations Act of 2009.¹ Section 626 of the Act directed

the Commission to commence, within 90 days of enactment, a rulemaking proceeding with respect to mortgage loans.² Section 626 also directed the FTC to use notice and comment procedures under Section 553 of the Administrative Procedure Act (APA), 5 U.S.C. 553, to promulgate these rules.³

On May 22, 2009, President Obama signed the Credit CARD Act.⁴ Section 511 of this statute clarified the Commission's rulemaking authority under the Omnibus Appropriations Act. First, Section 511 specified that the rulemaking "shall relate to unfair or deceptive acts or practices regarding mortgage loans, which may include unfair or deceptive acts or practices involving loan modification and foreclosure rescue services."⁵ The Omnibus Appropriations Act, as clarified by the Credit CARD Act, does not specify any particular types of provisions that the Commission should include, or refrain from including, in a rule addressing loan modification and foreclosure rescue services, but rather directs the Commission to issue rules that "relate to" unfairness or deception.⁶ Accordingly, the Commission interprets the Omnibus Appropriations Act to allow it to issue rules that prohibit or restrict conduct that may not be unfair or deceptive itself, but that are reasonably related to the goal of preventing unfairness or deception.⁷

Second, Section 511 of the Credit CARD Act clarified that the Commission's rulemaking authority was limited to entities that are subject to enforcement by the Commission under the FTC Act.⁸ The rules the Commission promulgates to implement the Omnibus Appropriations Act, therefore, cannot cover the practices of banks, thrifts, Federal credit unions,⁹ or certain nonprofits.¹⁰

¹ *Id.* § 626(a).

² *Id.* Because Congress directed the Commission to use these APA rulemaking procedures, the FTC did not use the procedures set forth in Section 18 of the FTC Act, 15 U.S.C. 57a.

³ Credit Card Accountability Responsibility and Disclosure Act of 2009, Public Law 111-24, 123 Stat. 1734 (Credit CARD Act).

⁴ *Id.* § 511(a)(1)(B).

⁵ *Id.*

⁶ Unlike Section 18 of the FTC Act, 15 U.S.C. 57a, see *Katharine Gibbs Sch. v. FTC*, 612 F.2d 658 (2d Cir. 1979), the Omnibus Appropriations Act, as clarified by the Credit CARD Act, does not require that the Commission identify with specificity in the rule the unfair or deceptive acts or practices that the prohibitions will prevent. Omnibus Appropriations Act § 626(a); Credit CARD Act § 511(a)(1)(B).

⁷ Credit CARD Act § 511(a)(1)(C).

⁸ 15 U.S.C. 45(a)(2).

⁹ 15 U.S.C. 44. Bona fide nonprofit entities are exempt from the jurisdiction of the FTC Act. Sections 4 and 5 of the FTC Act confer on the Commission jurisdiction over persons, partnerships, or corporations organized to carry on

The Omnibus Appropriations Act, as clarified by the Credit CARD Act, also permits both the Commission and the states to enforce the rules the FTC issues.¹¹ The Commission can use its powers under the FTC Act to investigate and enforce the rules, and the FTC can seek civil penalties under the FTC Act against those who violate them. In addition, states can enforce the rules by bringing civil actions in Federal district court or another court of competent jurisdiction to obtain civil penalties and other relief. Before bringing such an action, however, states must give 60 days advance notice to the Commission or other "primary federal regulator" of the proposed defendant, and the regulator has the right to intervene in the action.

On July 21, 2010, President Obama signed the Dodd-Frank Wall Street Reform and Consumer Protection Act.¹² The Dodd-Frank Act made substantial changes in the federal regulatory framework for providers of financial services. Among the changes, the Dodd-Frank Act will transfer the Commission's rulemaking authority under the Omnibus Appropriations Act to a new Bureau of Consumer Financial Protection (BCFP)¹³ on July 21, 2011, which is the "designated transfer date" that the Treasury Department has set.¹⁴ In addition, on the designated transfer date, the FTC's authority to "prescribe rules" and "issue guidelines" under the Omnibus Appropriations Act will transfer to the BCFP.¹⁵ Both the Commission and the BCFP, however, will have authority to bring law enforcement actions to enforce the rules promulgated under the Omnibus Appropriations Act, including the Final Rule in this Proceeding.

B. The Rulemaking and Public Comments Received

On June 1, 2009, the Commission published in the *Federal Register* an Advance Notice of Proposed

business for their profit or that of their members. 15 U.S.C. 44, 45(a)(2). The FTC does, however, have jurisdiction over for-profit entities that provide mortgage-related services as a result of a contractual relationship with a nonprofit organization. See *Nat'l Fed'n of the Blind v. FTC*, 420 F.3d 331, 334-35 (4th Cir. 2005). In addition, the Commission has jurisdiction over sham non-profits that in fact operate as for-profit entities. See *infra* note 176.

¹¹ Omnibus Appropriations Act § 626(b); Credit CARD Act § 511(a)(1)(B).

¹² Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010) (Dodd-Frank Act).

¹³ *Id.* § 1061.

¹⁴ Dep't of the Treasury, *Bureau of Consumer Financial Protection; Designated Transfer Date*, 75 FR 57252, 57253 (Sept. 20, 2010); see also Dodd-Frank Act § 1062.

¹⁵ Dodd-Frank Act § 1061.

¹ Omnibus Appropriations Act, 2009, Public Law 111-8, 123 Stat. 524 (Omnibus Appropriations Act).

Rulemaking (ANPR) addressing the acts and practices of for-profit companies that offer to work on behalf of consumers to help them modify the terms of their loans or to avoid foreclosure. The ANPR described these services generically as "Mortgage Assistance Relief Services," or "MARS."¹⁶ On March 9, 2010, the Commission published¹⁷ a Notice of Proposed Rulemaking (NPRM) and proposed rule addressing Mortgage Assistance Relief Services (MARS).¹⁸ Among other things, the proposed rule included provisions that would:

- Prohibit MARS providers from making false or misleading claims;
- Mandate that providers disclose certain information about their services;
- Bar the collection of advance fees for the provision of MARS, except in certain circumstances for attorneys who collect them in connection with preparing or filing documents in bankruptcy, court, or administrative proceedings;
- Prohibit anyone from providing substantial assistance or support to another they know or consciously avoid knowing is engaged in a violation of the rule; and
- Impose recordkeeping and compliance requirements.

In response to the NPRM, the Commission received 75 comments from stakeholders, including for-profit MARS providers, state law enforcers, consumer and community groups, state bars and bar associations, and financial service providers.¹⁹ The largest number

of comments—a total of 30—were submitted either by attorneys who provide MARS²⁰ or entities representing attorneys, including the American Bar Association and several state bar associations.²¹ These comments focused on the scope of the proposed rule's exemption for attorneys, asserting that the Commission should expand the exemption. Other commenters, including some consumer groups and a coalition of state bank examiners, also advocated that the proposed exemption for attorneys be broadened, although to a lesser extent than the attorneys and their representatives advocated.²² By contrast, comments from NAAG²³ and others²⁴ urged the Commission not to change the attorney exemption in the proposed rule.

Apart from comments that focused on the coverage of attorneys, most comments supported the proposed rule and its specific provisions. Most significantly, these comments generally supported an advance fee ban,²⁵ although a few non-attorney MARS providers opposed it.²⁶

II. Mortgage Assistance Relief Services

A. The Mortgage Crisis and Assistance for Consumers

As discussed in the ANPR and NPRM, historically high levels of consumer debt, increased unemployment, and a stagnant housing market have contributed to high rates of mortgage loan delinquencies, which in many cases lead to foreclosures.²⁷ As a result,

many consumers struggling to make their mortgage payments have been searching for ways to avoid default and foreclosure. There are a number of options that may be available to them, including: (1) Short sales or deeds-in-lieu of foreclosure transactions, in which the proceeds of a sale of the home or the receipt of the deed to the home, respectively, are treated by the mortgage lender as repayment of the outstanding mortgage balance; (2) forbearance or repayment plans that do not reduce the amount that consumers must pay but give them more time to bring their balance current; and (3) loan modifications that reduce consumers' indebtedness or the amount of their monthly payments. Because loan modifications allow consumers to stay in their homes and reduce their debt, this possible solution often has great appeal to them. The Commission's law enforcement experience suggests that loan modifications are the type of MARS most frequently marketed and sold.²⁸

In response to the mortgage crisis, government and private sector programs have been initiated to assist distressed homeowners.²⁹ In March 2009, the Obama Administration launched the Making Home Affordable (MHA) program and the MHA's Home Affordable Modification Program (HAMP), through which the government provides mortgage owners and servicers with financial incentives to modify and refinance loans.³⁰ Under the program,

Record 2.8 Million U.S. Properties With Foreclosure Filings in 2009 (Jan. 14, 2010), available at <http://www.realtytrac.com/contentmanagement/pressrelease.aspx?itemid=8333>; Credit Suisse Fixed Income Research 2 (2008) (forecasting a total of 9 million foreclosures for the period 2009 through 2012), available at <http://www.chapa.org/pdf/ForeclosureUpdateCreditSuisse.pdf>.

²⁸ See List of MARS Law Enforcement Actions, following Section V of the SBP, for a list of cases that the FTC has prosecuted ("FTC Case List"). Unless otherwise specified, all citations to FTC actions in this SBP refer to the complaints in these lawsuits.

²⁹ See, e.g., HOPE NOW, *About Us* ("HOPE NOW is an alliance between counselors, mortgage companies, investors, and other mortgage market participants. This alliance will maximize outreach efforts to homeowners in distress to help them stay in their homes and will create a unified, coordinated plan to reach and help as many homeowners as possible."), available at <http://www.hopenow.com/hopenow-aboutus.php>.

³⁰ For example, the program offers servicers that modify loans according to its guidelines an up-front fee of \$1,000 for each modification, "pay for success" fees on still-performing loans of \$1,000 per year, and one-time bonus incentive payments of \$1,500 to lender/investors, and \$500 to servicers, for a modification made while a borrower is still current on his or her mortgage payments. Dep't of the Treasury, *Making Home Affordable Summary of Guidelines 2* (March 4, 2010), available at

Continued

¹⁶ See *Mortgage Assistance Relief Services*, 74 FR 26130 (June 1, 2009) (*MARS ANPR*). In response to the ANPR, the Commission received a total of 46 comments, which are available at <http://www.ftc.gov/os/comments/mars/index.shtm>. Notably, a wide spectrum of these commenters, including a consortium of over 40 state attorneys general, consumer and community organizations, and financial service providers, strongly urged the Commission to propose a rule prohibiting or restricting the collection of fees for mortgage relief services until the promised services have been completed. Additionally, a majority of the comments expressed concern regarding pervasive deception and abuse in the marketing of MARS, including misrepresentations regarding the services MARS providers will perform and regarding their affiliation with the government, nonprofits, lenders, or loan servicers.

This SBP cites to comments submitted in response to both the ANPR and the NPRM. To distinguish the comments submitted in response to the ANPR, the notation "(ANPR)" is included in any citations to them.

¹⁷ See Press Release, FTC, *FTC Proposes Rule That Would Bar Mortgage Relief Companies From Charging Up-Front Fees* (Feb. 4, 2010), available at <http://www.ftc.gov/opa/2010/02/mars.shtm>.

¹⁸ See *Mortgage Assistance Relief Services*, 75 FR 10707 (Mar. 9, 2010) (*MARS NPRM*).

¹⁹ The comments submitted in response to the NPRM are available at <http://www.ftc.gov/os/comments/mars-nprm/index.shtm>. A list of those who submitted comments appears following Section V of this SBP.

²⁰ See, e.g., Deal; Greenfield.

²¹ See, e.g., Am. Bar Ass'n (ABA); ME BA at 1–2; OR Bar at 1; WI Bar at 1; GA Bar at 1; FL Bar at 1.

²² See, e.g., NCLC at 10–13; CSBS at 4–5.

²³ See NAAG at 3–4.

²⁴ See, e.g., CUUS at 8–9.

²⁵ See, e.g., MN AG at 3; OH AG at 1; MBA at 2–3 (supporting "strict prohibition" of advance fees); NAAG at 2 ("The advance fee ban is the linchpin of effective deterrence of fraudulent practices by providers of mortgage relief services."); NCLC at 3 ("The single most important provision is section 322.5, which prohibits the collection of any fee before providing tangible results of real value to consumers."); AFSA at 5 ("Banning upfront fees is the best way for the FTC to ensure that MARS providers do really provide consumers with a beneficial service."); see also CSBS at 3; CUUS at 6; NYC DCA at 3.

²⁶ See, e.g., Metropolis; RMI; Hirsch.

²⁷ See, e.g., *MARS NPRM*, 75 FR at 10708–09; MBA, *Delinquencies, Foreclosure Starts Increase in Latest MBA National Delinquency Survey* (May 19, 2010) ("The delinquency rate for mortgage loans on one-to-four-unit residential properties increased to a seasonally adjusted rate of 10.06 percent of all loans outstanding as of the end of the first quarter of 2010, an increase of 59 basis points from the fourth quarter of 2009, and up 94 basis points from one year ago."), available at <http://www.mbaa.org/NewsandMedia/PressCenter/72906.htm>; NCLC at 2; Press Release, Realtytrac, *Year-end Report Shows*

lenders and servicers have approved roughly 500,000 permanent loan modifications.³¹ The Treasury Department has also recently expanded the MHA program to assist more borrowers, for example, by introducing additional incentives for servicers to write down the outstanding principal balance for borrowers who are “under water,” that is, who owe more on their mortgages than the value of their homes.³²

On April 5, 2010, the Administration launched the Home Affordable Foreclosure Alternatives (HAFA) Program, which provides servicers with incentives to enter into short sales or deeds-in-lieu of foreclosure transactions with consumers who do not qualify for a loan modification under the MHA program.³³ In addition, state and local governments, nonprofit organizations, housing counselors, and private sector entities³⁴ have offered a variety of other programs and services to help homeowners in financial distress.³⁵

Despite these public and private programs and services, consumers also continue to seek assistance from for-

profit companies who act as intermediaries between consumers and their lenders or servicers in obtaining mortgage assistance relief services—including loan modifications. This may be happening for a number of reasons. First, MARS have been advertised and marketed widely in mass media and online, with the result that consumers may be more aware of the services offered by for-profit entities than they are of other available programs. Second, many consumers who are seeking loan modifications or other relief are not eligible for the MHA program or other government and private assistance programs. While the Treasury Department has estimated that the MHA program will help 3–4 million borrowers by February 2012,³⁶ industry reports estimate that roughly twice that number of mortgage loans currently are in delinquency or foreclosure.³⁷ Third, even among consumers who may be eligible to obtain a temporary loan modification under the MHA program, many do not qualify for a permanent loan modification.³⁸ Fourth, even if

consumers are eligible for government programs or assistance directly from their servicers or lenders, many housing counselors and servicers have struggled to respond in a timely manner to the extraordinary number of consumers who are seeking loan modifications.³⁹ Finally, the Treasury Department also has observed that some servicers have not adequately met consumer demand for loan modifications under the HAMP program.⁴⁰

Many consumers who have been unable to obtain mortgage assistance relief services through their own efforts have turned to for-profit MARS providers for help. Providers promoting their ability to negotiate with lenders and servicers to obtain loan modifications or some other type of mortgage relief have proliferated in the past few years.⁴¹ Responding to consumer demand, many providers have promised to obtain loan modifications,⁴² but others have begun

http://www.ustreas.gov/press/releases/reports/guidelines_summary.pdf.

³¹ See, e.g., Dep’t of the Treasury, *Making Home Affordable Program: Servicer Performance Report Through September 2010* (Oct. 25, 2010), available at <http://www.financialstability.gov/docs/Sept%20MHA%20Public%202010.pdf>. Further, if trial modifications are added to permanent modifications, over 1.6 million modifications have been approved. *Id.*, Testimony of Herbert M. Allison, Dep’t of the Treasury, “Foreclosure Prevention: Is the Home Affordable Modification Program Preserving Homeownership?,” before the H. Comm. on Oversight and Gov’t Reform, at 5 (Mar. 25, 2010), available at http://oversight.house.gov/images/stories/Hearings/Committee_on_Oversight/2010/032510_HAMP/TESTIMONY-Allison.pdf.

³² See Press Release, Making Home Affordable (“MHA”) Housing Program Enhancements Offer Additional Options for Struggling Homeowners (Mar. 26, 2010), available at http://makinghomeaffordable.gov/pr_03262010.html.

³³ See MHA, *Home Affordable Foreclosure Alternatives (HAFA) Program*, available at <http://makinghomeaffordable.gov/hafa.html>.

³⁴ Loan holders also have exhibited a growing willingness to modify loan terms for borrowers who do not qualify for loan modifications under government programs such as HAMP. These are known as “proprietary loan modifications.” See Press Release, HOPE NOW, *HOPE NOW Reports More Than 476,000 Loan Modifications in the First Quarter of 2010* (May 10, 2010), available at http://www.hopenow.com/press_release/files/1Q%20Data%20Release_05_10_10.pdf (reporting that the industry completed 312,329 proprietary loan modifications in the first quarter of 2010).

³⁵ See, e.g., Freddie Mac, *Foreclosure Prevention Workshops for Consumers*, <http://www.freddiemac.com/avoidforeclosure/workshops.html> (describing local credit counseling events by local governments and nonprofits); FTC, *Mortgage Payments Sending You Reeling? Here’s What to Do* (2009), available at <http://www.ftc.gov/bcp/edu/pubs/consumer/homes/reat04.pdf> (describing various credit counseling alternatives).

³⁶ See, e.g., Press Release, MHA, *Making Home Affordable Program on Pace to Offer Help to Millions of Homeowners* (Aug. 4, 2009) available at http://www.makinghomeaffordable.gov/pr_08042009.html; Dep’t of the Treasury, *Making Home Affordable Program: Servicer Report Through June 2010 at 7 n.2* (June 2010) (“Selected Outreach Measures” table), available at <http://www.financialstability.gov/docs/June%20MHA%20Public%20Revised%20080610.pdf>.

³⁷ See Alan Zibel, *Foreclosures Down 2 Percent From Last Year*, Associated Press, May 13, 2010 (noting that as of March 2010, “[n]early 7.4 million borrowers, or 12 percent of all households with a mortgage, had missed at least one month of payments or were in foreclosure”), available at <http://abcnews.go.com/Business/wireStory?id=10632332>; see also Press Release, Mortgage Bankers Ass’n, *Delinquencies, Foreclosure Starts Fall in Latest MBA National Delinquency Survey* (Feb. 19, 2010) (noting that roughly 15% of mortgage loans were delinquent or in foreclosure and that “[t]he percentages of loans 90 days or more past due and loans in foreclosure set new record highs”), available at <http://www.mbaa.org/NewsandMedia/PressCenter/71891.htm>; Stephanie Armour, *Home Foreclosure Rates Posts First Annual Decline in Five Years*, USA Today (May 13, 2010) (noting that nearly one-fourth of borrowers owe more on their mortgages than the value of their homes).

³⁸ See, e.g., Dep’t of the Treasury, *MHA Servicer Report June 2010 at 1*; NCR, *NCR Home Affordable Modification Program Survey 2010*, at 2 (noting that, as of February 2010, only 12.5% of trial modifications had been converted into permanent modifications), available at http://www.ncrc.org/images/stories/MediaCenter_reports/hamp_report_2010.pdf; *Foreclosure Prevention: Is the Home Affordable Modification Program Preserving Homeownership: Hearing Before the H. Comm. on Oversight & Gov’t Reform*, 111th Cong. (2010) (statement of Gene Dodaro, Acting Comptroller General, Government Accountability Office) (prepared statement at 7), available at http://oversight.house.gov/images/stories/Hearings/Committee_on_Oversight/2010/032510_HAMP/TESTIMONY-Dodaro.pdf (noting that 32% of trial modifications lasting three months or more had been approved for conversion into permanent modifications).

³⁹ See, e.g., CRL at 3 (noting that MARS have flourished as “consumers’ demand for relief outpaces the capacity of mortgage servicers and government programs alike”); *The Recently Announced Revisions to the Home Affordable Modification Program (HAMP): Hearing Before the Subcomm. on Hous. & Cmty. Opportunity of the H. Comm. on Fin. Servs.*, 111th Cong. 131 (2010) (statement of Alan White, Assistant Professor, Valparaiso Univ.), available at <http://financialservices.house.gov/Media/file/hearings/111/Printed%20Hearings/111-122.pdf>. (“Modification requests are languishing for as long as a year, servicers repeatedly ask borrowers to resubmit documentation that has been lost or become outdated, and housing counselors and mediators are unable to get timely information and responses from servicers.”); NCLC (ANPR) at 2 (noting that servicers have failed to meet borrower demand for loan modifications); NAAG (ANPR) at 7 (noting that borrowers have had difficulty reaching servicers and obtaining their assistance).

⁴⁰ See, e.g., *Holding Banks Accountable: Are Treasury and Banks Doing Enough to Help Families Save Their Homes?: Hearing Before the S. Subcomm. on Fin. Servs. & Gen. Gov’t of the S. Comm. on Appropriations*, 111th Cong. (2010) (statement of Timothy Geithner, Sec’y, Dep’t of the Treasury) (“[W]e do not believe that servicers are doing enough to help homeowners.”)

⁴¹ See MARS ANPR, 74 FR at 26134–35.

⁴² See, e.g., *Safe Mortgage Licensing Act: HUD Responsibilities Under the Safe Act, Proposed Rule*, 74 FR 66548, 66554 (Dec. 15, 2009) (“HUD has seen a substantial increase in the number of third-party actors (i.e., individuals other than lenders and loan servicers) offering their services as intermediaries putatively to work on behalf of borrowers to negotiate modifications of existing loan terms.”); NAAG (ANPR) at 2 (“[T]he [loan modification] consulting business model is dominating the marketplace. Consultants are by far the most common source of consumer complaints received by our offices in the area of mortgage assistance services.”); OH AG (ANPR) at 2 (“For those companies that actually do put some effort into helping the consumer, the most common business model is an offer to negotiate a loan modification or repayment plan with the consumer’s servicer.”); CRC (ANPR) at 1 (“In California, advertisements promising loan modification success are inescapable.”); FinCEN, *Loan Modification and Foreclosure Rescue Scams—Evolving Trends and*

to market short sales and other forms of relief.⁴³ The Commission's law enforcement experience shows that MARS providers typically are small and relatively new businesses,⁴⁴ and thus it is difficult to estimate their numbers.⁴⁵ Based on the law enforcement actions brought by the FTC and the states, however, it appears that there are over

Patterns in Bank Secrecy Act Reporting 10 (May 2010), available at <http://www.fincen.gov/newsroom/rp/files/MLFLoanMODForeclosure.pdf> (FinCEN Report) ("Reports of foreclosure rescue scams increased substantially in the last eight months of calendar year 2009.").

⁴³ Although the dominant trend among MARS providers is to offer loan modifications, over the past few years some providers also have offered other purported types of loss mitigation and foreclosure avoidance. See, e.g., *FTC v. Foreclosure Solutions, LLC*, No. 1:08-cv-01075 (N.D. Ohio filed Apr. 28, 2008) (alleging that provider offered to stop foreclosure proceedings and secure workout plans with consumers' lenders or servicers); *FTC v. Mortgage Foreclosure Solutions, Inc.*, No. 8:08-cv-388-T-23EAJ (M.D. Fla. filed Feb. 26, 2008) (same). Providers may adjust their marketing to offer newly-minted forms of mortgage relief—for example, the possibility of entering a short sale under the HAFA program. See, e.g., *Illinois v. Home Foreclosure Solutions LLC*, No. 08CH43259 (Ill. Cir. Ct. Cook County 2008) (alleging MARS provider offered to assist consumers to enter short sales). Another new variation of MARS is charging an advance fee to purportedly "eliminate" mortgage debts by challenging the legality of the original mortgages. See FinCEN, *Foreclosure Rescue Fraud Report May 2010*, supra note 42 at 9. MARS providers also have offered "sale-leaseback" or "title reconveyance" transactions. In these transactions, MARS providers instruct consumers to transfer title to their homes to the providers and then the consumers rent the homes from them. The providers promise to reconvey title at some later date, yet often do not do so, thereby taking the equity in the homes. Sale-leaseback and title reconveyance transactions appear to have become less prevalent, in part because many consumers do not have sufficient equity in their homes to make this strategy profitable. See, e.g., FinCEN, *Foreclosure Rescue Fraud Report May 2010*, supra note 42 at 4.

⁴⁴ See FTC Case List. Some of these small and relatively new businesses are law firms. For example, NCLC surveyed members of the National Association of Consumer Advocates (NACA) and the National Association of Consumer Bankruptcy Attorneys (NACBA); 298 attorneys responded that they provided some form of MARS. NCLC at 5; see also IRELA at 1 (stating that many of the 2,000 members of the Illinois Real Estate Lawyers Association are "engaged in the process of trying to assist their consumer clients in dealing with foreclosures, mortgage loan workouts, and related matters").

⁴⁵ See, e.g., U.S. Gov't Accountability Office, *GAO-10-787, Federal Efforts to Combat Foreclosure Rescue Schemes are Under Way, but Improved Planning Elements Could Enhance Progress* 12-16 (July 2010) ("GAO Report") (noting that data on MARS providers is limited); NAAG (ANPR) at 3 ("It is difficult to gather exact empirical data on companies providing loan modification and foreclosure rescue services due to the predominance of Internet-based companies and their ephemeral nature."); OH AG (ANPR) at 2 ("There is little reliable data about the foreclosure rescue industry."); CRL at 3 ("With few barriers to entry and little to no oversight, scams are flourishing in the current environment.").

500 such providers in the United States.⁴⁶

Typically, MARS providers charge consumers hundreds or thousands of dollars⁴⁷ in advance fees, i.e., fees prior to providing their services. In its law enforcement actions, the FTC has observed that some providers collect their entire fee at the beginning of the transaction,⁴⁸ while others collect two to three large installment payments from consumers.⁴⁹ NAAG and other commenters also stated that many MARS providers have begun to offer their services piecemeal, collecting fees upon reaching various stages in the process, such as assembling the documentation required by the lender or servicer, mailing paperwork to the lender or servicer, and negotiating with a lender's loss mitigation department.⁵⁰

As discussed in the ANPR and NPRM, MARS providers often claim to possess specialized knowledge of the mortgage lending industry,⁵¹ sometimes touting

⁴⁶ See NAAG (ANPR) at 4 (noting that state attorneys general have investigated more than 450 MARS providers); FTC Case List, supra note 28; Press Release, FTC, *Federal and State Agencies Crack Down on Mortgage Modification and Foreclosure Rescue Scams* (Apr. 6, 2009), available at <http://www.ftc.gov/opa/2009/04/hud.shtm> (reporting that the Commission sent warning letters to 71 companies offering MARS).

⁴⁷ See, e.g., infra notes 48-49; GAO Report, supra note 45, at 7 (noting that MARS typically charge a fee of thousands of dollars); Dargon at 2 ("We charge \$2,500 as a flat fee" in advance.); CRC (ANPR) at 2 ("The average fee that we are seeing borrowers charged is \$3,000; we have seen fees as high as \$9,500. In nearly every instance, these fees are charged up front, before any services have been rendered."); NCRC (ANPR) at 3 (noting that "[t]ypically, loan modification companies request a significant fee upfront" and that a study performed by NCRC "documented a median fee of \$2,900," although "[f]ees ranged as high as \$5,600"); NCLR (ANPR) at 1 (observing fees as high as \$8,000); NCLC (ANPR) at 5-6 (estimating typical advance fees to be between \$2,000 and \$4,000).

⁴⁸ See, e.g., supra note 47; *FTC v. Infinity Group Servs.*, No. SACV09-00977 DOC (MLGx) (C.D. Cal. filed Aug. 26, 2009); *FTC v. Freedom Foreclosure Prevention Specialists, LLC*, No. 2:09-cv-01167-FJM (D. Ariz. June 1, 2009); *FTC v. Fed. Loan Modification Law Ctr., LLP*, No. SACV09-401 CJC (MLGx) (C.D. Cal. filed Apr. 3, 2009).

⁴⁹ See, e.g., *FTC v. Truman Foreclosure Assistance, LLC*, No. 09-23543 (S.D. Fla. filed Nov. 23, 2009); *FTC v. Washington Data Res., Inc.*, No. 8:09-cv-02309-SDM-TBM (M.D. Fla. filed Nov. 12, 2009); *FTC v. First Universal Lending, LLC*, No. 09-CV-82322, Mem. Supp. TRO at 5 (S.D. Fla. filed Nov. 24, 2009); see also, e.g., Dargon at 2; Rogers at 13.

⁵⁰ See, e.g., LFSV at 2 ("[W]e have seen MARS providers who are effectively evading the advance fee prohibition in California law by charging for their 'services' in 'phases.'"); NAAG at 3; LCCR at 5; see also *FTC v. Debt Advocacy Ctr., LLC*, No. 1:09CV2712 (N.D. Ohio filed Nov. 19, 2009).

⁵¹ See, e.g., NCLC (ANPR) at 3 ("Some modification firms claim superior expertise even though there are no recognized qualifications other than the training programs offered by HUD to certified agencies. Instead, some for-profit entities tout their experience as mortgage industry

their hiring of former mortgage brokers and real estate agents⁵² to bolster their claims of purported expertise. In addition, some attorneys—including solo practitioners and small law firms that represent financially distressed individuals—increasingly have been offering MARS in connection with their legal practice.⁵³

A number of non-attorney MARS providers are employing or affiliating with lawyers, with the providers representing that they are offering traditional legal services.⁵⁴ Although these providers often tout the expertise of these attorneys in negotiating with lenders and servicers, in many instances the attorneys do little or no *bona fide* legal work.⁵⁵ In some cases, MARS

insiders."); NAAG (ANPR) at 4; *FTC v. Fed Housing Modification Dept.*, No. 09-CV-01759 (D.D.C. filed Sept. 15, 2009) (alleging defendants' Web sites state that many of their "skilled negotiators" have "worked for the lenders they are dealing with"); *FTC v. US Foreclosure Relief Corp.*, No. SACV09-768 JVS (MGX), Mem. Supp. TRO at 4-5 (C.D. Cal. filed July 7, 2009) (alleging that defendants "boasted of twenty years' experience" and that they had "extensive experience in the industry"); *FTC v. Truman Foreclosure Assistance, LLC*, No. 09-23543, Mem. Supp. P.I. at 20 (S.D. Fla. filed Nov. 23, 2009) (alleging that defendants' Web sites represented that they have "extensive loss mitigation experience" and that "they are led by a seasoned and proven team of professionals"); see also *FTC v. LucasLawCenter "Inc."*, No. 09-CV-770 (C.D. Cal. filed July 7, 2009).

⁵² See, e.g., NCLC (ANPR) at 11 ("Mortgage brokers—often cited as one of the driving forces in the growth of bad subprime loans—are in demand to work for loan modification companies. One MARS advertised for consultants with mortgage and real estate experience to join its cadre of loan modification specialists."); GAO Report, supra note 45, at 10 ("Federal and state officials and representatives of nonprofit organizations told us that persons who have conducted foreclosure rescue schemes include former mortgage industry professionals who had been involved in the subprime market. * * *").

⁵³ See generally Greenfield; Deal; Giles. See also NCLC at 4.

⁵⁴ See, e.g., NAAG at 3-4 ("We have noticed that national companies are recruiting for attorney "partners" or "local counsel" in all of the states they work in to evade states' mortgage rescue fraud statutes."); IL AG at 1; *FTC v. Loss Mitigation Servs., Inc.*, No. SACV09-800 DOC (ANX), Mem. Supp. Pls. Ex Parte App. at 3 (Aug. 3, 2009) (alleging that defendants engaged in "misrepresentations prohibited by the TRO, behind a new facade: the "Walker Law Group," which was "nothing more than a sham legal operation designed to evade state law restrictions on the collection of up-front fees for loan modification and foreclosure relief"); *FTC v. LucasLawCenter "Inc."*, No. SACV-09-770 DOC (ANX) (C.D. Cal. filed July 7, 2009); *FTC v. Data Med. Capital Inc.*, No. SA-CV-99-1266 AHS (Ex) (C.D. Cal., contempt application filed May 27, 2009); *FTC v. US Foreclosure Relief Corp.*, No. SACV09-768 JVS (MGX) (C.D. Cal. filed July 7, 2009); *FTC v. Fed. Loan Modification Law Ctr., LLP*, No. SACV09-401 CJC (MLGx) (C.D. Cal. filed Apr. 3, 2009); see also *Cincinnati Bar Assoc. v. Mullaney*, 119 Ohio St. 3d 412 (2008) (disciplining attorneys involved in mortgage assistance relief services).

⁵⁵ See supra note 54. The experiences detailed in one comment from an attorney illustrate the role

Continued

providers also offer "forensic audits," during which attorneys purportedly conduct a legal analysis of mortgage loan documents to find law violations, thereby supposedly helping consumers acquire leverage over their lenders or servicers to obtain a better loan modification.⁵⁶ Providers offering forensic audits also assert that, because of their relationships with attorneys, state laws that prohibit non-attorneys from collecting advance fees for loan modification services do not apply to them.⁵⁷ For example, California law previously imposed a number of restrictions on "foreclosure consultants," but allowed "licensed attorneys * * * [to] charge advance fees under certain limited circumstances."⁵⁸ The State Bar of California subsequently observed that "foreclosure consultants may be attempting to avoid the statutory prohibition on collecting a fee before any services have been rendered by having a lawyer work with them in foreclosure consultations."⁵⁹ California

that attorneys play or have been asked to play in connection with MARS:

I had numerous non-attorney modification companies ask me to serve as their lawyer and accept a flat fee on each file. I would get this money and do little or no work for it. In some cases I would take in the advance fee and then disburse a share to the loan officer producing the deal and a share to the company actually doing the work. Or I would be collecting the advance fee and then holding all or part of it in my trust account until the modification was completed. I declined to get involved in such arrangements.

Deal at 6.

⁵⁶ See, e.g., MN AG at 2 ("Recently, so-called forensic loan auditors have emerged as a new type of mortgage assistance relief 'service.'"); 1st ALC at 3 (MARS provider stating it engages in forensic audits); Dargon at 2 (same); see also *FTC v. Debt Advocacy Ctr., LLC*, No. 1:09CV2712 (N.D. Ohio Am. Compl. filed May 14, 2010) (alleging defendants purporting to offer forensic audits misrepresented that "between 80–90% of all loans [they] have audited have some form of rights violations"); *FTC v. Data Med. Capital Inc.*, No. SA-CV-99-1266 AHS (Eex), Mem. Supp. App. Contempt at 18 (C.D. Cal. filed May 27, 2009); *FTC v. Fed. Loan Modification Law Ctr., LLP*, No. SACV09-401 CJC (MLGx) (C.D. Cal. filed Apr. 3, 2009).

Since publication of the NPRM, the Commission has released an alert to warn consumers about entities purporting to provide forensic audits, *FTC, Forensic Mortgage Loan Audit Scams: A New Twist on Foreclosure Rescue Fraud* (Mar. 2010), available at <http://www.ftc.gov/bcp/edu/pubs/consumer/alerts/alt177.shtm>; see also, e.g., Cal. Dep't of Real Estate, Consumer Alert 6 (Mar. 2009) (warning consumers of "forensic loan reviews"), available at http://www.dre.ca.gov/pdf_docs/FraudWarningsCaDRE03_2009.pdf.

⁵⁷ See *supra* notes 51–56; see also IL AG (ANPR) at 2 ("Attorneys are using the [state] exemption to market and sell the same mortgage consulting services provided by non-attorneys.")

⁵⁸ Press Release, Office of the Att'y Gen., Cal. Dep't of Justice, *Brown Alerts Homeowners that New Law Prohibits Up-front Fees for Foreclosure Relief Services* (Oct. 15, 2009), available at <http://ag.ca.gov/newsalerts/release.php?id=1821>.

⁵⁹ See State Bar of Cal., *Ethics Alert: Legal Services to Distressed Homeowners and Foreclosure*

has since passed a new law that removes this attorney exemption.⁶⁰

B. Unfair or Deceptive Practices in the Marketing of MARS

The FTC, state attorneys general, and other law enforcement agencies, have extensive experience with MARS providers. In the past three years, the Commission has filed 32 law enforcement actions against providers of loan modification and foreclosure rescue services.⁶¹ State attorneys general have investigated at least 450 MARS providers and sued hundreds of them for alleged state law violations.⁶² Additionally, the Department of Justice and other agencies, working both individually and jointly, have pursued MARS providers for illegal conduct.⁶³ As discussed in more detail below, the evidence in the record, including extensive law enforcement experience, demonstrates that the unfair or deceptive practices of MARS providers are widespread and are causing substantial consumer harm.⁶⁴ Indeed,

Consultants on Loan Modifications ("Cal. State Bar Ethics Alert") 2, Ethics Hotliner (Feb. 2, 2009), available at <http://www.calbar.ca.gov/calbar/pdfs/ethics/Ethics-Alert-Foreclosure.pdf>; see also *Florida Bar, Ethics Alert: Providing Legal Services to Distressed Homeowners 1*, available at [http://www.floridabar.org/TFB/TFBResources.nsf/Attachments/872C2A9D7B71F05785257569005795DE/\\$FILE/loanModification20092.pdf?OpenElement](http://www.floridabar.org/TFB/TFBResources.nsf/Attachments/872C2A9D7B71F05785257569005795DE/$FILE/loanModification20092.pdf?OpenElement) ("The Florida Bar's Ethics Hotline recently has received numerous calls from lawyers who have been contacted by non-lawyers seeking to set up an arrangement in which the lawyers are involved in loan modifications, short sales, and other foreclosure-related rescue services on behalf of distressed homeowners. * * * The [Florida] Foreclosure Rescue Act * * * imposed restrictions on non-lawyer loan modifiers to protect distressed homeowners. The new statute appears to be the impetus for these inquiries.")

⁶⁰ Cal Civ. Code § 2944.7; see also Press Release, Office of the Att'y Gen., Cal. Dep't of Justice, *Brown Alerts Homeowners that New Law Prohibits Up-front Fees for Foreclosure Relief Services* (Oct. 15, 2009), available at <http://ag.ca.gov/newsalerts/release.php?id=1821>.

⁶¹ See FTC Case List, *supra* note 28.

⁶² NAAG (ANPR) at 4; IL AG (ANPR) at 1 (noting that Illinois has over 240 open investigations of MARS providers and filed 28 lawsuits against them); Press Release, FTC, *Federal and State Agencies Target Mortgage Relief Scams* (Nov. 24, 2009) (announcing 118 actions by 26 federal and state agencies), available at <http://www.ftc.gov/opa/2009/11/stolenhope.shtm>; Press Release, FTC, *Federal and State Agencies Target Mortgage Foreclosure Rescue and Loan Modification Scams* (July 15, 2009) (announcing operation involving 189 actions by 25 federal and state agencies), available at <http://www.ftc.gov/opa/2009/07/loanlies.shtm>; Press Release, *Financial Fraud Enforcement Task Force, Financial Fraud Enforcement Task Force Announces Results of Broadest Mortgage Fraud Sweep in History* (June 17, 2010), available at <http://www.stopfraud.gov/news/news-06172010-02.html>.

⁶³ See *infra* notes 92–96 and accompanying text.

⁶⁴ See, e.g., LFSV at 1 ("During the recent mortgage crisis, we have been dealing with a flood

one recent survey of state and local consumer agencies found that the fastest growing category of consumer complaints concerned the failure of MARS providers to fulfill their promises to help save consumers' homes from foreclosure.⁶⁵

MARS providers commonly initiate contact with prospective customers through Internet, radio, television, or direct mail advertising.⁶⁶ Although MARS providers did not submit information for the record relating to the extent and cost of their marketing efforts, they appear to use a variety of media to target large numbers of consumers who are struggling to pay their mortgages. For example, one MARS provider that was the subject of an FTC enforcement action spent \$9 million in one year to broadcast deceptive advertisements nationwide on major television and cable networks, as well as on radio stations and the Internet.⁶⁷ Typical MARS advertisements instruct consumers to call a toll-free telephone number or to e-mail the provider. One provider's advertisements allegedly yielded 1,500 inbound calls per day.⁶⁸ Another such provider disseminating direct mail advertisements reported receiving approximately 500 inbound calls per day.⁶⁹

Customary representations in the ads and ensuing telemarketing and email pitches claim that the MARS provider (1) will obtain for the consumer a substantial reduction in a mortgage loan's interest rate, principal amount, or monthly payments; (2) will achieve these results within a specific period of time; ⁷⁰ (3) has special relationships

of borrowers whose mortgages are distressed and who have been subject to abuses by companies and individuals promising assistance with obtaining modification of those loans.")

⁶⁵ See Consumer Fed'n of Am. et al., 2009 Consumer Complaint Survey Report 3 (July 27, 2010), available at http://www.consumerfed.org/elements/www.consumerfed.org/File/Consumer_Complaint_Survey_Report2009.pdf.

⁶⁶ The FTC procured information from a media monitoring company on the occurrence of broadcast advertising for MARS. The company located 68 radio ads and 71 television and cable ads containing the terms "save your home," "mortgage modification," or "loan modification." These ads aired between the dates of September 1, 2008 and September 1, 2010. These ads were attributable to 139 different companies.

⁶⁷ See *FTC v. Fed. Loan Modification Law Ctr., LLP*, No. SACV09-401 CJC (MLGx), Mem. Supp. Ex Parte TRO at 6–7 (C.D. Cal. filed Apr. 6, 2009).

⁶⁸ *Id.* at 6–8.

⁶⁹ See *FTC v. Loss Mitigation Servs., Inc.*, No. SACV-09-800 DOC (ANX), Mem. Supp. TRO at 7 (C.D. Cal. filed Jul. 13, 2009).

⁷⁰ See, e.g., *FTC v. First Universal Lending, LLC*, No. 09-CV-82322, Mem. Supp. TRO at 4–5 (S.D. Fla. filed Nov. 24, 2009); *FTC v. 1st Guar. Mortgage Corp.*, No. 09-DV-61846 (S.D. Fla. filed Nov. 17, 2009); *FTC v. Freedom Foreclosure Prevention*

with lenders and servicers;⁷¹ and (4) is closely affiliated with the government,⁷² nonprofit programs,⁷³ or the consumer's lender or servicer.⁷⁴ Providers also commonly represent that there is a high likelihood, and in some instances a "guarantee," of success.⁷⁵ Many MARS

Specialists, LLC, No. 2:09-cv-01167-FJM (D. Ariz. filed June 1, 2009); *FTC v. Fed. Loan Modification Law Ctr., LLP*, No. SACV09-401 CJC (MLGx) (C.D. Cal. filed Apr. 3, 2009).

⁷¹ See, e.g., *FTC v. Debt Advocacy Ctr., LLC*, No. 1:09CV2712 (N.D. Ohio filed Nov. 19, 2009); *FTC v. 1st Guar. Mortgage Corp.*, No. 09-DV-61846 (S.D. Fla. filed Nov. 17, 2009); *FTC v. LucasLawCenter "Inc."*, No. SACV-09-770 DOC (ANX) (C.D. Cal. filed July 7, 2009); *FTC v. US Foreclosure Relief Corp.*, No. SACV09-768 JVS (MGX) (C.D. Cal. filed July 7, 2009).

⁷² See, e.g., *FTC v. Dominant Leads, LLC*, No. 1:10-cv-00997 (D.D.C. filed June 16, 2010) (alleging that defendants' Web sites featured official government seals and logos, and deceptively appeared to be affiliated with the government); *FTC v. Washington Data Res., Inc.*, No. 8:08-cv-02309-SDM-TBM (M.D. Fla. filed Nov. 12, 2009) (alleging that defendants falsely represented that they were affiliated with the United States government); *FTC v. Fed. Housing Modification Dept.*, No. 09-CV-01753 (D.D.C. filed Sept. 15, 2009); *FTC v. Sean Gantier*, No. 1:09-cv-00894 (D.D.C. filed July 10, 2009) (alleging defendants placed advertisements on Internet search engines that refer consumers to Web sites that deceptively appear to be affiliated with government loan modification programs); *FTC v. Thomas Ryan*, No. 1:09-00535 (HHK) (D.D.C. filed Mar. 25, 2009); *FTC v. Fed. Loan Modification Law Ctr., LLP*, No. SACV09-401 CJC (MLGx) (C.D. Cal. filed Apr. 3, 2009) (charging defendant with misrepresenting that it is part of or affiliated with the federal government); see also LOLLAF at 2 ("Other clients have been deceived into believing the MARS provider will assist them because it claimed to be a 'non-profit,' used a government symbol or claimed to be affiliated with the HOPE hotline."); OH AG (ANPR) at 4 ("Our office has seen many companies that have names or advertisements that make it sound like they are government sponsored."); NCLC (ANPR) at 3 ("One website, USHUD.com, even claims to be 'America's Only Free Foreclosure Resource' even though HUD-certified agencies also offer free assistance regardless of income.");

⁷³ See *FTC v. New Hope Prop. LLC*, No. 1:90-cv-01203-JBS-JS (D.N.J. filed Mar. 17, 2009); *FTC v. New Hope Modifications, LLC*, No. 1:09-cv-01204-JBS-JS (D.N.J. filed Mar. 17, 2009).

⁷⁴ See, e.g., *FTC v. Kirkland Young, LLC*, No. 09-23507 (S.D. Fla. filed Nov. 18, 2009) (alleging that defendants falsely represented an affiliation with borrowers' lenders); *FTC v. Loss Mitigation Servs., Inc.*, No. SACV-09-800 DOC (ANX) (C.D. Cal. filed July 13, 2009) (alleging that defendants deceptively claimed affiliation with consumers' lenders); see also Am. Bankers Ass'n (ANPR) at 7 ("They often misuse the intellectual property of lenders and servicers by claiming in mailings, on Web sites, and in other communications that they either are affiliated with the lenders and servicers or have special relationships with them that do not exist. They use the names, trademarks and logos of these lenders and servicers in their advertising to deceive consumers into believing they can obtain modification relief for them that these consumers could not otherwise obtain for themselves at no cost."); Chase (ANPR) at 3 ("These MARS entities also may lead the borrower to believe that they are associated with the servicer or that they have special agreements with the servicer for processing loan modifications, when, in fact, they do not.");

⁷⁵ See, e.g., *FTC v. Truman Foreclosure Assistance, LLC*, No. 09-23543 (S.D. Fla. filed Nov.

providers do not disclose to consumers in their promotions the cost of their services.⁷⁶ In some cases, MARS providers entice consumers to make substantial up-front payments with false claims that they will be able to obtain a refund if consumers do not receive an acceptable result.⁷⁷

23, 2009) (alleging defendants falsely claimed success rate of 97 to 100%); *FTC v. Debt Advocacy Ctr., LLC*, No. 1:09CV2712 (N.D. Ohio filed Nov. 19, 2009) (alleging defendants falsely claimed a 90% success rate); *FTC v. Loss Mitigation Servs., Inc.*, No. SACV09-800 DOC (ANX) (C.D. Cal. filed July 13, 2009) (alleging "[d]efendants have told homeowners that their success rate is above ninety percent"); *FTC v. LucasLawCenter "Inc."*, No. SACV-09-770 DOC (ANX) (C.D. Cal. filed July 7, 2009) (alleging "[d]efendants' representatives tell consumers that Defendants have a success rate in the ninetieth percentile with their lender"); *FTC v. Freedom Foreclosure Prevention Specialists, LLC*, No. 2:09-cv-01167-FJM (D. Ariz. filed June 1, 2009) (alleging defendants claimed to have 97% success rate); *FTC v. Data Med. Capital Inc.*, No. SA-CV-99-1266 AHS (Ex), Mem. Supp. App. Contempt at 8 (C.D. Cal. filed May 27, 2009) (alleging defendants represented 100% success rate to consumers).

The Loan Modification Scam Prevention Network (LMSPN)—a coalition of Federal and state organizations led by the Lawyers' Committee for Civil Rights—has created a nationwide complaint reporting system for loan modification fraud. The Network, formed in February 2010, has received complaints through a variety of channels, including a form posted on its Web site, the Homeowners' Hope Hotline, and referrals from non-profit housing counselors. As of August 25, 2010, the LMSPN database contained a total of 6,473 complaints of loan modification fraud, dating as far back as April 8, 2008. FTC staff reviewed a random sample of 100 of these complaints and found that 63 reported that MARS providers had guaranteed consumers loan modifications. In projecting this finding to the entire LMSPN database, the FTC estimates that between 52% and 72% of the complaints report the same information.

⁷⁶ In a recent report summarizing the results of undercover calls made to MARS providers, the National Community Reinvestment Coalition (NCRC) found that in 54% of the calls the providers did not inform consumers about their fees. See NCRC, *Foreclosure Rescue Scams: A Nightmare Complicating the American Dream*, at 21 (Mar. 2010) ("NCRC Report"), available at <http://www.ncrc.org/images/stories/pdf/research/foreclosure%20rescue%20scams%20-%20%20nightmare%20complicating%20the%20american%20dream.pdf>.

⁷⁷ See, e.g., *FTC v. Truman Foreclosure Assistance, LLC*, No. 09-23543 (S.D. Fla. filed Nov. 23, 2009) (alleging that defendant falsely claimed to provide "100% money back guarantee"); *Debt Advocacy Ctr., LLC*, No. 1:09CV2712 (N.D. Ohio filed Nov. 19, 2009) (alleging that defendants falsely represented they will refund borrower fee if unsuccessful); *FTC v. Infinity Group Servs.*, No. SACV09-00977 DOC (MLGx) (C.D. Cal. filed Aug. 26, 2009); *FTC v. Loan Modification Shop, Inc.*, No. 3:09-cv-00798 (JAP), Mem. Supp. TRO at 1 (D.N.J. amended complaint filed Aug. 4, 2009) (alleging defendants represented that advance fees were fully refundable); *FTC v. Freedom Foreclosure Prevention Specialists, LLC*, No. 2:09-cv-01167-FJM (D. Ariz. June 1, 2009) (alleging defendants promised "100% money-back guarantee" but then failed to provide refunds); see also NAAG at 2 ("[MARS providers] generally ignore their own refund policies. In the vast majority of complaints received by our offices, consumers were unable to get refunds even though the consultants performed

Based on the FTC's law enforcement experience, the public comments, and consumer complaints, it appears that the vast majority of consumers do not receive the results MARS providers promise.⁷⁸ After collecting their up-front fees, MARS providers often fail to make initial contact with the consumer's lender or servicer for months, if at all, or to have substantive discussions or negotiations with the lender or servicer.⁷⁹ In many cases, MARS providers fail to perform even the most basic promised services or achieve any beneficial results.

In some cases, providers also cause harm to consumers by instructing them to stop communicating with their lenders and servicers.⁸⁰ Consumers who

little or no work and had promised consumers money-back guarantees. In some cases, the companies had closed or changed locations by the time the consumers discovered there was a problem, thereby preventing the consumers from even requesting a refund."); see also, e.g., *FTC v. Home Assure, LLC*, No. 8:09-CV-00547-T-23T-Sm, Mot. S.J., App.1 at 6 (M.D. Fla. filed Jan. 25, 2010) (Expert Report of Dr. Kivetz survey reporting that 56% of consumers requested that defendant provide a refund; 65% of those who requested a refund did so because defendant failed to perform its services; but only 12% of consumers who requested refunds received them).

⁷⁸ See, e.g., *infra* Section III.E.2.a.; LOLLAF at 1 ("We have worked with many homeowners who have paid money to a Mortgage Assistant Relief Services (MARS) provider, only to discover that they received absolutely no service in exchange for the fee."); CMC (ANPR) at 1 ("CMC members and other mortgage servicers found that MARS providers consistently misrepresent their ability to obtain concessions from servicers * * *"); Chase (ANPR) at 3 ("They collect their fees up-front and promise the borrower they can get a loan modification or other foreclosure relief, when, in fact, this is only a determination that the servicer can make after reviewing the borrower's financial information and investor agreements.");

⁷⁹ See, e.g., *FTC v. Truman Foreclosure Assistance, LLC*, No. 09-23543 (S.D. Fla. filed Nov. 23, 2009) (alleging that defendant often failed to return borrowers' phone calls and failed to contact and negotiate with lenders); *FTC v. Apply2Save, Inc.*, No. 2:09-cv-00345-EJL-CWD (D. Idaho filed July 14, 2009) (complaint alleging that "[m]any consumers learned from their lenders that Defendants had not even contacted the lender or that Defendants had only minimal, non-substantive contact with the lender"); *FTC v. Loss Mitigation Servs., Inc.*, No. SACV09-800 DOC (ANX) (C.D. Cal. filed July 13, 2009) (alleging that "[d]efendants have misrepresented that negotiations were underway, although Defendants had not yet contacted the lender"); *FTC v. LucasLawCenter "Inc."*, No. SACV-09-770 DOC (ANX), Mem. Supp. TRO at 19 (C.D. Cal. filed July 7, 2009) (alleging that consumers who contact their lenders "learn that [Defendant] never even contacted the lender, or merely verified the consumer's loan information"); *FTC v. Freedom Foreclosure Prevention Specialists, LLC*, No. 2:09-cv-01167-FJM (D. Ariz. June 1, 2009) (alleging that defendants failed to act on homeowners' cases for more than four to six weeks without completing—or in some cases, even starting—negotiations and "failed to return consumers' repeated telephone calls, even when homeowners were on the brink of foreclosure").

⁸⁰ See, e.g., *FTC v. Truman Foreclosure Assistance, LLC*, No. 09-23543 (S.D. Fla. filed Nov.

Continued

sever contact with lenders and servicers unwittingly diminish their ability to learn that their MARS provider is doing little or nothing on their behalf. These consumers may never learn of concessions their lenders or servicers would be willing to make—or, worst of all, may never discover that foreclosure is imminent.⁸¹ In some cases, MARS providers also advise consumers to discontinue making their mortgage payments even though doing so could result in the loss of their homes and damage to their credit ratings.⁸²

23, 2009); *FTC v. Kirkland Young, LLC*, No. 09-23507 (S.D. Fla. filed Nov. 18, 2009); *FTC v. Washington Data Res., Inc.*, No. 8:09-cv-02309-SDM-TBM (M.D. Fla. filed Nov. 12, 2009); *FTC v. Loss Mitigation Servs., Inc.*, No. SACV09-800 DOC (ANX) (C.D. Cal. filed July 13, 2009); *FTC v. US Foreclosure Relief Corp.*, No. SACV09-768 JVS (MGX) (C.D. Cal. filed July 7, 2009); see also NCRC Report, *supra* note 76, at 4 (noting that, on 25% of its undercover calls, MARS providers instructed the caller to cease communicating with his or her lender).

⁸¹ See, e.g., *FTC v. Truman Foreclosure Assistance, LLC*, No. 09-23543 (S.D. Fla. filed Nov. 23, 2009) (alleging that “[w]hen consumers speak with their lenders directly, they often discover that Defendants had not yet contacted the lender or only had left messages or had non-substantive contacts with the lender”); *FTC v. Loss Mitigation Servs., Inc.*, No. SACV09-800 DOC (ANX), Mem. Supp. TRO at 18-19 (C.D. Cal. filed July 13, 2009) (detailing “devastating effects” of consumers learning too late of lack of effort by loan modification company); CRC (ANPR) at 7 (“People who do have a chance of keeping the home are being steered away from legitimate, free homeowner counseling services or are failing to take any action before it is too late because they have been assured everything is being taken care of for them already.”).

⁸² See NAAG at 4 (“We are aware of a number of rescue consultants who incorrectly claim that consumers’ lenders will not work with them until they are behind on their mortgage payments. We are also aware of consultants who advise consumers not to make mortgage payments so that they will be able to afford mortgage loan modification fees.”); CUNA at 2 (consumers “are often instructed to stop making mortgage payments”); NCLC at 7 (family told “to stop paying their mortgage payments and promised a loan modification with lower payments.”); Rodriguez at 1 (“I have had clients face foreclosure because of these companies telling them to stop paying their mortgage and pay them!”); *FTC v. Fed. Loan Modification Law Ctr., LLP*, No. SACV09-401 CJC (MLGX) (C.D. Cal., Am. Compl. filed June 24, 2009) (“In numerous instances, Defendants have [allegedly] encouraged consumers to stop paying their mortgages, telling consumers that delinquency will demonstrate the consumer’s hardship to the lender and make it easier to obtain a loan modification.”); *FTC v. LucasLawCenter “Inc.”*, No. SACV-09-770 DOC (ANX) (C.D. Cal. filed July 9, 2009) (alleging that “[i]n numerous instances, Defendants’ representative encourages consumers to stop paying their mortgages, telling consumers that delinquency will demonstrate the consumers’ hardship to the lender and make it easier to obtain a loan modification.”); *FTC v. Foreclosure Solutions, LLC*, No. 1:08-cv-01075 (N.D. Ohio filed Apr. 28, 2008) (“Defendants [allegedly] instruct the consumer to open a savings account and deposit, every month until further notice from Defendants, the consumer’s monthly mortgage payment plus an additional [25%]. Defendants claim this money will be used to negotiate with the lender to reinstate the loan.”); see also *FTC v. First Universal Lending, LLC*, No. 09-

The Commission’s law enforcement experience,⁸³ state law enforcement,⁸⁴ the comments received,⁸⁵ and state bar actions⁸⁶ indicate that a growing

CV-82322 (S.D. Fla. filed Nov. 24, 2009); *FTC v. Fed. Housing Modification Dep’t*, No. 09-CV-01753 (D.D.C. filed Sept. 15, 2009); *FTC v. Loss Mitigation Servs., Inc.*, No. SACV09-800 DOC(ANX) (C.D. Cal. filed July 13, 2009); *FTC v. US Foreclosure Relief Corp.*, No. SACV09-768 JVS (MLGX) (C.D. Cal., Am. Compl. filed Mar. 8, 2009); *FTC v. New Hope Property LLC*, No. 1:09-cv-01203-JBS-JS (D.N.J. filed Mar. 17, 2009); NCRC Report, *supra* note 76, at 24 (“[I]n over 50% of the tests service providers advised testers that they should not pay their mortgage.”); NAAG (ANPR) at 10 (“In some cases, the mortgage consultants will actually counsel the consumer not to make a mortgage payment, which of course frees up funds for the consultants’ fee.”).

⁸³ See *infra* notes 89-90.

⁸⁴ See, e.g., *Florida v. Kirkland Young*, No. 09-90945 (Fla. Cir. Ct. Miami-Dade Cty., filed Dec. 17, 2009), available at <http://myfloridalegal.com/webfiles.nsf/WF/MRAY-7YXQF7/Sfile/Complaint.121709.pdf>. Press Release, N.C. Dep’t of Justice, *AG Cooper Targets California Schemes that Prey on NC Homeowners* (July 15, 2009), available at <http://www.ncdoj.com/News-and-Alerts/News-Releases-and-Advisories/Press-Releases/AG-Cooper-targets-California-schemes-that-prey-on-asp>; Press Release, Colo. Att’y Gen. Office, *Attorney General Announces Actions Against Seven Loan-Modification Companies As Part of Multistate Sweep* (July 15, 2009), available at http://www.coloradoattorneygeneral.gov/press/news/2009/07/15/attorney_general_announces_actions_against_seven_loan_modification_companies_p; Press Release, Ill. Att’y Gen., *Illinois Attorney General Sues 14th Company for Mortgage Rescue Fraud* (Aug. 28, 2009), available at http://www.illinoisattorneygeneral.gov/pressroom/2008_08/20080828.html.

⁸⁵ See, e.g., Deal at 5-6 (“Some non-attorney modification companies claimed to have attorneys on staff or available to review the work or to negotiate with lenders. A few lawyers ‘rented’ their names to non-attorney MARS providers while providing little service.”); IL AG (ANPR) at 1 (noting that “33 percent of the [MARS] companies we have dealt with are owned by attorneys, while 38 percent have some link to the legal profession”); CRC (ANPR) at 2 (“An increasing number of attorneys are involving themselves in these unethical practices without providing any legal (or other) services. . . .”); MN AG (ANPR) at 5 (“This Office is aware of several loan modification and foreclosure rescue companies that have affiliated with licensed attorneys in other states in an effort to circumvent state law.”); NAAG (ANPR) at 4 (“Attorneys * * * have an increasing presence in this industry and have been found working in conjunction with or serving as referral sources for mortgage consultants.”).

⁸⁶ See, e.g., *Legislative Solutions for Preventing Loan Modification and Foreclosure Rescue Fraud: Hearing Before the Subcomm. on Hous. & Cmty. Opportunity of the H. Comm. on Fin. Servs.*, 111th Cong. 58 (2009) (statement of Scott J. Drexel, Chief Trial Counsel, State Bar of California), available at <http://financialservices.house.gov/media/file/hearings/111/111-28.pdf> at 2, 4 (Drexel Testimony) (noting that attorney misconduct in connection with MARS “is a problem of extremely significant—if not crisis—proportions in California,” and that the state bar has initiated over 175 associated investigations of attorneys); Polyana Da Costa, *Record Number of Complaints Target Florida Loan Modification Lawyers*, Law.com (Oct. 1, 2009) (“The [Florida] state attorney general has received a record 756 complaints through August of this year about loan modifications involving attorneys.”), available at <http://www.law.com/jsp/law/LawArticleFriendly.jsp?id=1202434223147>.

number of attorneys themselves market and sell MARS. Many of them engage in unfair and deceptive acts and practices, such as making the specific claim that they offer legal services,⁸⁷ when in fact, no attorneys are employed by the company, or if they are, they do little or no legal work for customers.⁸⁸

C. Continued Law Enforcement and Other Responses

The Commission has taken aggressive action to protect consumers from deceptive MARS providers. As noted above, the FTC has filed 32 lawsuits⁸⁹ in the last three years against MARS providers for engaging in deceptive practices in violation of the FTC Act and, in several instances, the Telemarketing Sales Rule (TSR).⁹⁰ In addition, the FTC has coordinated its efforts with state law enforcement and other federal agencies, including the Department of Justice (DOJ), the Department of Housing and Urban Development (HUD), the Treasury Department, and the Office of the Special Inspector General for the Troubled Asset Relief Program (SIG-TARP).⁹¹ The Commission also is a member of the Financial Fraud

⁸⁷ See, e.g., *FTC v. Fed. Housing Modification Dep’t*, No. 09-CV-01753 (D.D.C. filed Sept. 16, 2009) (alleging that defendants falsely claim to have attorneys or forensic accountants on staff); *FTC v. Loan Modification Shop, Inc.*, No. 3:09-cv-00798 (JAP), Mem. Supp. TRO at 14 (D.N.J. filed Aug. 4, 2009) (alleging that defendants misrepresent “that it is an attorney-based company”); see also *FTC v. LucasLawCenter “Inc.”*, No. SACV-09-770 DOC (ANX), Mem. Supp. TRO at 19 (C.D. Cal. filed July 7, 2009) (alleging that “[d]espite promises to the contrary, consumers have no contact with the purported attorneys who are supposed to be negotiating with their lenders”).

⁸⁸ See, e.g., *FTC v. Truman Foreclosure Assistance, LLC*, No. 09-23543 (S.D. Fla. filed Nov. 23, 2009); *FTC v. Washington Data Res., Inc.*, No. 8:09-cv-02309-SDM-TBM (M.D. Fla. filed Nov. 12, 2009); see also *FTC v. US Foreclosure Relief Corp.*, No. SACV09-768 JVS (MGX), Prelim. Rep. Temp. Receiver at 2-3 (C.D. Cal. filed July 7, 2009) (stating that defendants’ “relationship with two different lawyers was nominal at best and served primarily as a cover to dignify the business and invoke the attorney exception to advance fee prohibitions”).

⁸⁹ See FTC Case List, *supra* note 28.

⁹⁰ 16 CFR 310.1, *et seq.* (2003); see, e.g., *FTC v. Kirkland Young, LLC*, No. 09-23507 (S.D. Fla. filed Nov. 18, 2009); *FTC v. Washington Data Res., Inc.*, No. 8:09-cv-02309-SDM-TBM (M.D. Fla. filed Nov. 12, 2009); *FTC v. First Universal Lending, LLC*, No. 09-CV-82322 (S.D. Fla. filed Nov. 24, 2009); *FTC v. Fed. Housing Modification Dep’t*, No. 09-CV-01753 (D.D.C. filed Sept. 15, 2009); *FTC v. Hope Now Modifications, LLC*, No. 1:09-cv-01204-JBX-JS (D.N.J. filed Sept. 14, 2009); *FTC v. US Foreclosure Relief Corp.*, No. SACV09-768 JVS (MGX) (C.D. Cal. filed July 7, 2009).

⁹¹ See Press Release, *FTC, Federal and State Agencies Target Mortgage Foreclosure Rescue and Loan Modification Scams* (July 15, 2009), available at <http://www.ftc.gov/opa/2009/07/loanlies.shtm>; Press Release, *FTC, Federal and State Agencies Crack Down on Mortgage Modification and Foreclosure Rescue Scams* (Apr. 6, 2009), available at <http://www.ftc.gov/opa/2009/04/hud.shtm>.