

Testimony of John Rao

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Before the United States Senate  
Committee on the Judiciary

Field Hearing of the Subcommittee on  
Administrative Oversight and the Courts

**“Mandatory Mediation Programs: Can Bankruptcy Courts  
Help End the Foreclosure Crisis?”**

October 28, 2010

Chairman Whitehouse, thank you for holding this hearing and for inviting me to testify today concerning the potential role of mandatory mediation and loss mitigation programs in the bankruptcy courts as an effective tool in addressing our foreclosure crisis. I testify here today on behalf of the low income clients of the National Consumer Law Center (NCLC).<sup>1</sup> NCLC provides legal and technical assistance on consumer law issues to legal services, government and private attorneys representing low-income consumers across the country. The clients and constituencies of NCLC collectively encompass a broad range of families and households who have been affected by current foreclosure crisis.

In my work as an attorney at NCLC, I provide training and technical assistance to attorneys and housing counselors across the country representing homeowners who are facing foreclosure. Because of my extensive experience in bankruptcy matters, I often speak at educational programs for bankruptcy attorneys, trustees and judges, and I serve

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

as a member of the federal Judicial Conference Advisory Committee on Bankruptcy Rules. My testimony is based on this work and over twenty-six years experience representing consumers in debt collection, bankruptcy and foreclosure defense matters, initially as an attorney with Rhode Island Legal Services and head of its Consumer Unit.

### **HAMP Has Failed to Curb the Foreclosure Crisis**

The nation continues to endure the worst foreclosure crisis since the Great Depression. According to the Mortgage Bankers Association National Delinquency Survey for the fourth quarter of 2009, the combined percentage of loans in foreclosure or seriously delinquent was 15.02 percent, the highest ever recorded in the MBA delinquency survey.<sup>2</sup> Goldman Sachs estimates that, starting at the end of the last quarter of 2008 through 2014, 13 million foreclosures will be started.<sup>3</sup>

The situation in Rhode Island is more dire than in most areas of the nation. With over ten percent of home mortgages in the state past due, Rhode Island ranked highest among all New England states in the most recent Mortgage Bankers Association National Delinquency Survey.<sup>4</sup> Nationwide, only seven states had a higher rate of delinquent home loans than Rhode Island. At the end of the First Quarter of 2010 there were 19,869

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<sup>2</sup> Mortgage Bankers Association, *National Delinquency Survey Quarter 4 2009* (Feb. 19, 2010).

<sup>3</sup> Goldman Sachs Global ECS Research, *Home Prices and Credit Losses: Projections and Policy Options* (Jan. 13, 2009), at 16; *see also* Rod Dubitsky, Larry Yang, Stevan Stevanovic & Thomas Suehr, Credit Suisse Fixed Income Research, *Foreclosure Update: Over 8 Million Foreclosures Expected* (Dec. 4, 2008) (predicting 9 million foreclosures for the period 2009-2012).

<sup>4</sup> Mortgage Bankers Association, *National Delinquency Survey Quarter 1 2010* (March 31, 2010).

past-due home mortgage loans in the state.<sup>5</sup> With an increase in foreclosures of 123% from the last quarter of 2009 through the first quarter of 2010, Rhode Island led all fifty states in the rate of increase in new foreclosure cases.<sup>6</sup> It is projected that during the years 2009 through 2012, a total of 31,192 homes will proceed to foreclosure in Rhode Island.<sup>7</sup> Not surprisingly, Rhode Island is one of the first ten states designated by the U.S. Treasury Department to receive special foreclosure assistance funds under the “Hardest Hit Fund” states initiative.<sup>8</sup>

The primary government response to the foreclosure crisis has been the Treasury Department’s Home Affordable Modification Program (HAMP), announced by President Obama’s administration on March 4, 2009. However, HAMP is not providing a sufficient number of permanent loan modifications to homeowners.

Implementation of HAMP by servicers continues to be slow and hampered by administrative problems. While Treasury has made important improvements to the program’s design in the past year, the lack of compliance by servicers and enforcement by Treasury with program guidelines continues to prevent HAMP from reaching its stated goals. The Administration’s most recent report on HAMP progress shows that 495,898

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<sup>5</sup> Center for Responsible Lending, *Cost of Bad Lending Fact Sheet: Rhode Island*: <http://www.responsiblelending.org/mortgage-lending/tools-resources/factsheets/rhode-island.html>.

<sup>6</sup> Mortgage Bankers Association, *National Delinquency Survey Quarter 1 2010* (March 31, 2010).

<sup>7</sup> Center for Responsible Lending, *Cost of Bad Lending Fact Sheet: Rhode Island*: <http://www.responsiblelending.org/mortgage-lending/tools-resources/factsheets/rhode-island.html>

<sup>8</sup> United States Department of Treasury Press Release March 29, 2010: <http://www.ustreas.gov/press/releases/tg618.htm>.

permanent loan modifications have been made.<sup>9</sup> Treasury had initially projected that HAMP would modify 3 to 4 million mortgages over a three year period. Assistant Treasury Secretary Herbert Allison, in responding to questioning last year from the Senate Banking Committee, stated that the program would need to do 1 million modifications per year agreed in order to meet Treasury's goals.<sup>10</sup> With less than 500,000 permanent modifications made in its first year and a half in operation, HAMP is significantly lagging behind these early projections. The recent Treasury report also suggests that the number of modifications being made is actually declining, with only 35,297 trial modifications and 27,840 permanent modifications made in September 2010. Moreover, even if HAMP reached its stated goals, the majority of all foreclosures would still be unaddressed.

Another huge problem that has developed in the first year of HAMP is that a large number of homeowners were put on temporary loan modifications and then denied permanent modifications. Treasury's September, 2010 report shows that 699,924 homeowners have had their trial modifications canceled since the start of the program. Although trial modifications are intended to last only for three months, many homeowners have been making payments on trial plans for a year or more before even receiving a decision that their permanent modification has been denied based on some program eligibility requirement. These homeowners are often worse off at this point because they now face renewed foreclosure proceedings and a large arrearage based on

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<sup>9</sup> United States Department of the Treasury, *Making Home Affordable Program Servicer Performance Report Through September 2010*, available at <http://www.financialstability.gov/docs/Sept%20MHA%20Public%202010.pdf>.

<sup>10</sup> *Preserving Homeownership: Progress Needed to Prevent Foreclosures: Hearing Before the Senate Commi. on Banking, Housing & Urban Affairs*, 111<sup>th</sup> Cong. (July 16, 2009) (Senator Schumer's question of Assistant Treasury Secretary Herbert Allison).

the difference between their trial plan payment and their regular unmodified mortgage payment. For homeowners who were not in default when they went on the trial modification, they now have negative credit reports that will hurt any chance they may have had to obtain a loan refinancing.

Perhaps the biggest problem with HAMP is that it is effectively the “only game in town.” No other national program has been put in place to assist homeowners in foreclosure. To make matters worse, HAMP has relied solely on the voluntary efforts of mortgage servicers to implement the program, and these efforts have been woefully inadequate. Neither Congress nor Treasury has developed an enforcement mechanism to combat servicer noncompliance with HAMP. Treasury has used various incentives to encourage servicer participation, but these carrots have not resulted in servicer compliance with HAMP guidelines. Moreover, Congress’ failure to amend the Bankruptcy Code to permit mortgage modifications in bankruptcy court has meant that homeowners have not had an effective stick to leverage modifications both in and outside bankruptcy.

### **Bankruptcy Court Mediation and Loss Mitigation Programs.**

The Loss Mitigation Program for the Bankruptcy Court for the District of Rhode Island was commenced on November 1, 2009, and was implemented by General Order 09-003.<sup>11</sup> The Court’s Loss Mitigation Program is similar to a loss mitigation program

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<sup>11</sup> Amendments to the Rhode Island Loss Mitigation Program were made by General Orders 10-001 and 10-002, which became effective on January 15, 2010 and April 2, 2010. *See* General Order Adopting Second Amended Loss Mitigation Program and Procedures (Bankr. D. R.I. 2010), 10-002, available at <http://www.rib.uscourts.gov/newhome/RulesInfo/generalorders.asp>.

implemented by the Bankruptcy Court for the Southern District of New York (and certain judges in the Eastern District of New York).<sup>12</sup> The stated purpose of the Loss Mitigation Program and similar programs is to “bring debtors and secured lenders together, to encourage them to discuss mutually beneficial financial resolution of their home mortgage difficulties, in a climate where both debtors and creditors are at risk of suffering great pecuniary harm even if they were acting prudently.”<sup>13</sup> Serving as a case management function, the program is intended to “avoid or reduce unnecessary bankruptcy litigation and cost to debtors and secured creditors.”<sup>14</sup>

The bankruptcy court programs are similar to the numerous programs adopted nationwide by state and local courts in response to the foreclosure crisis. These courts have recognized the need for a degree of heightened judicial supervision over foreclosures to help avoid hundreds of thousands of families from losing their homes unnecessarily. County courts serving such large cities as Chicago, Philadelphia, Cleveland, and Pittsburgh have implemented foreclosure conference and mediation programs similar to the Rhode Island and New York Loss Mitigation Programs.<sup>15</sup> Courts

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<sup>12</sup> See *In re* Adoption of Loss Mitigation Program Procedures, GENERAL ORDER #M-364 (Bankr. S.D.N.Y. 2009), available at [www.nysb.uscourts.gov/orders/m364.pdf](http://www.nysb.uscourts.gov/orders/m364.pdf)

<sup>13</sup> *In re* Simarra, 2010 WL 2144150 (Bankr. D.R.I. April 14, 2010).

<sup>14</sup> General Order 09-003.

<sup>15</sup> Chicago, Philadelphia, Cleveland, Pittsburgh Cook County Chicago Court Program: <http://cookcountyforeclosurehelp.org/about/>; Philadelphia County: [http://s98001.gridserver.com/images/pdf/foreclosure\\_mortgage/foreclosure\\_med\\_prog\\_by\\_state/pa\\_philly\\_pilot\\_program.pdf](http://s98001.gridserver.com/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/pa_philly_pilot_program.pdf); Cuyahoga County (Cleveland): [http://s98001.gridserver.com/images/pdf/foreclosure\\_mortgage/foreclosure\\_med\\_prog\\_by\\_state/ohio\\_prgm\\_summary.pdf](http://s98001.gridserver.com/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/ohio_prgm_summary.pdf); Allegheny County (Pittsburgh): [http://s98001.gridserver.com/images/pdf/foreclosure\\_mortgage/foreclosure\\_med\\_prog\\_by\\_state/pa\\_pitts\\_admin\\_order.pdf](http://s98001.gridserver.com/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/pa_pitts_admin_order.pdf)

in smaller cities, as diverse as Santa Fe, New Mexico and Louisville, Kentucky, have followed suit.<sup>16</sup>

In addition to these initiatives from local courts, state supreme courts have implemented similar programs. The New Jersey Supreme Court promulgated rules for a uniform statewide foreclosure mediation program.<sup>17</sup> In Delaware, the president judge of the state's superior courts issued a mediation rule applicable to all the state's superior courts.<sup>18</sup> The Ohio Supreme Court has established a model program which common pleas courts in many of the state's most populous counties have implemented.<sup>19</sup> Most recently, Florida's Supreme Court announced a statewide initiative that requires mediation automatically in all foreclosure cases filed in that state.<sup>20</sup>

In addition to these court-initiated programs, the legislatures in several states have recently enacted statutes which direct state courts to implement various forms of conference and mediation programs for foreclosure cases. These include programs now in effect in Connecticut, Indiana, Maine, New York, and Vermont.<sup>21</sup> In the non-judicial

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<sup>16</sup> Santa Fe First Judicial District Admin Order:  
[http://s98001.gridserver.com/images/pdf/foreclosure\\_mortgage/foreclosure\\_med\\_prog\\_by\\_state/nm\\_admin\\_order.pdf](http://s98001.gridserver.com/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/nm_admin_order.pdf) Jefferson County Kentucky Admin Order:

[http://s98001.gridserver.com/images/pdf/foreclosure\\_mortgage/foreclosure\\_med\\_prog\\_by\\_state/kentucky\\_admin\\_order.pdf](http://s98001.gridserver.com/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/kentucky_admin_order.pdf)

<sup>17</sup> <http://www.nj.gov/foreclosuremediation/resources.html>

<sup>18</sup> <http://www.deforeclosurehelp.org/mediation.html>

<sup>19</sup> *See:*

[http://s98001.gridserver.com/images/pdf/foreclosure\\_mortgage/foreclosure\\_med\\_prog\\_by\\_state/ohio\\_prgm\\_model.pdf](http://s98001.gridserver.com/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/ohio_prgm_model.pdf) . Cities with programs in effect include Cleveland, Cincinnati, Columbus, Toledo, and Akron.

<sup>20</sup> Florida Supreme Court: No. AOSC09-54 *Re: Final Report and recommendations on residential Mortgage Foreclosure Cases* (December 28, 2009)

[http://www.floridasupremecourt.org/pub\\_info/documents/AOSC09-54\\_Foreclosures.pdf](http://www.floridasupremecourt.org/pub_info/documents/AOSC09-54_Foreclosures.pdf).

<sup>21</sup> Connecticut (Conn. Gen. Stat. Ann. § 8-265ee); Indiana (2009 Senate Enrolled Act No. 492); Maine (14 Maine Rev. Stat. Ann. § 6321-A); New York (New York Civil Practice Laws Rule § 3408); Vermont (2010 House Bill 590). The Supreme Court of South

foreclosures states of California, Oregon, Maryland, Michigan, and Nevada the legislatures have enacted forms of conference and mediation requirements for foreclosure cases, with varying degrees of court involvement.<sup>22</sup> Even local Rhode Island municipalities such as the Cities of Providence and Cranston have initiated similar requirements.

All of these programs, including the Rhode Island and New York Bankruptcy Courts' Loss Mitigation Programs, have several features in common. They are designed to bridge the communication gap between loan servicers and homeowners, a gap that has often been cited as the major obstacle to effective loss mitigation. The programs require active participation by a representative of the servicer with full authority to consider all loss mitigation options. They regulate production of documents and facilitate some form of meeting between the homeowner and servicer, either in person or by phone. The courts play a role in supervising and, when necessary, intervening to move the process along. The programs do not require servicers or lenders to implement a particular loss mitigation option. In the bankruptcy context, these programs importantly do not compel a modification of the mortgage creditor's claim and therefore are not in violation of section 1322(b)(2) of the Bankruptcy Code.<sup>23</sup> Instead, they set a standard for transparency and accountability in the foreclosure process that is often lacking without

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Carolina has issued an administrative order that, while not requiring a specific form of conference, requires servicers to certify completion of HAMP-related loss mitigation reviews as a condition to proceeding with a foreclosure in the state. S.C. Administrative Order No. 2009--05-22-01 *Re: Mortgage Foreclosures and the Home Affordable Modification Program (HMP)*.

[http://www.floridasupremecourt.org/pub\\_info/documents/AOSC09-54\\_Foreclosures.pdf](http://www.floridasupremecourt.org/pub_info/documents/AOSC09-54_Foreclosures.pdf).

<sup>22</sup> California (Cal. Civ. Code § 2923.5 and §§ 2923.52-53); Maryland (2010 House Bill 472 (Chapter 485); Michigan (2009 Enrolled Bills 4453, 4454, 4455); Nevada (2009 Enacted Assembly Bill 149); Oregon (Enrolled Senate Bill 628).

<sup>23</sup> See *In re Simarra*, 2010 WL 2144150 (Bankr. D.R.I. April 14, 2010).

this intervention. The Rhode Island and New York Bankruptcy Courts' Loss Mitigation Programs have all of these attributes and function with procedures modeled after many similar programs in effect in courts around the country.

### **Bankruptcy Court Mediation Programs Can Make a Difference**

Legislation permitting mortgage modifications in chapter 13 bankruptcy cases would have been the most effective way to encourage servicers to modify home mortgages. Even without that authority, however, bankruptcy courts can play an important role in assisting voluntary loan modifications. In many respects, bankruptcy courts are ideally suited to facilitate mortgage modifications through implementation of mediation programs such as those in Rhode Island and New York. These reasons include:

- 1. Breaking Through Bureaucratic Barriers.** Homeowners routinely encounter numerous bureaucratic barriers in attempting to obtain HAMP modifications. Homeowners are repeatedly asked to provide documents because they are lost by servicers.<sup>24</sup> Housing counselors report waits of months to hear back on review for a trial modification. The Providence Journal reported that a Rhode Island homeowner mailed 99 pages of financial documentation to her servicer and four months later, still had not been notified that her modification had been approved.<sup>25</sup> In another case, Select Portfolio Services advised counsel for a New York borrower on three separate occasions over six weeks that the necessary broker price opinion had been cancelled due to "system errors"

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<sup>24</sup> Peter S. Goodman, *Paper Avalanche Buries Plan to Stem Foreclosures*, N.Y. Times, June 28, 2009.

<sup>25</sup> *See For Struggling R.I. homeowners, federal help is slow to come*, Providence Journal, Aug. 15, 2009.

and a new request would have to be submitted. Many homeowners are not able to endure these burdensome requests and simply give up in their pursuit of a loan modification.

When homeowners facing foreclosure have been unable to obtain a loan modification or other loss mitigation option from their mortgage holders, they have often turned to bankruptcy as a last resort for saving their homes. Unlike most homeowners in the foreclosure process who are not represented by counsel, more than 90% of individuals who file bankruptcy in most judicial districts have an attorney. These attorneys can assist homeowners in navigating through the numerous HAMP document requests. Moreover, mediation and loss mitigation programs such as those in New York and Rhode Island require the homeowner and servicer to designate contact persons for the exchange of information. Importantly, these programs provide for the entry of a Loss Mitigation Order which specifies time deadlines for requests of information by the servicer and responses by homeowners. If a servicer makes unjustified and duplicative requests for information, the homeowner's attorney can seek compliance with the Loss Mitigation Order. Likewise, a servicer can seek to end the process if the homeowner does not comply with valid HAMP document requests.

**2. Negotiating in Good Faith.** Too often homeowners wait for months (and more than a year in some cases) to get a decision on a HAMP modification request. These long delays exist with respect to both decisions on eligibility for trial modifications as well as for permanent modifications. These delays occur despite HAMP guidelines which require servicers to render a decision on a completed HAMP application within 30 calendar days.<sup>26</sup> More troubling than this paralysis in rendering a decision is that

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<sup>26</sup> U.S. Treasury Dept. HAMP Supplemental Directives, No. 09-07, p. 7; No. 10-01, p. 3.

homeowners may simply never get a decision at all on a HAMP modification, and are instead offered a “proprietary” modification on less favorable terms than HAMP.

The advantage of mediation programs is that they generally require that each of the participating parties designate a person having authority to resolve the matter. For example, the Rhode Island loss mitigation program requires that each Loss Mitigation Party “must have a designated person with full settlement authority present during the loss mitigation session.”<sup>27</sup> Both the Rhode Island and New York loss mitigation programs also require that the parties negotiate in good faith.<sup>28</sup> While these programs do not compel a servicer to provide a loan modification, they ensure that homeowners have a fair opportunity for consideration of their HAMP applications. If a servicer fails to comply with deadlines and other requirements contained in the Loss Mitigation Order, the homeowner may seek an order from the bankruptcy court compelling compliance with the Order.<sup>29</sup> This is critically important for homeowners in non-judicial foreclosure states such as Rhode Island where there is no judge overseeing the foreclosure process.

Since the Rhode Island loss mitigation program began in November 2009, of those cases that have completed the loss mitigation mediation process (262 cases), 174 cases were denied, withdrawn, terminated, vacated or dismissed (66.4%), and 88 cases (approximately 33.6%) resulted in a successful approved loan modification. Because 6 cases had more than one modification agreement due to a second mortgage or second property, there have been a total of 94 Loan Modification Agreements approved through

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<sup>27</sup> See Rhode Island General Order Adopting Second Amended Loss Mitigation Program and Procedures, Part VIII, subpart D.

<sup>28</sup> See Rhode Island General Order Adopting Second Amended Loss Mitigation Program and Procedures, Part VII, subpart A.

<sup>29</sup> *Id.*

September 30, 2010. While this may seem modest, I believe that many if not most of these modifications would not have occurred if the loss mitigation program was not in place.

**3. Providing Basic Due Process.** A major failing of HAMP is that homeowners are often never told the reason their modification request has been denied. Participating mortgage servicers routinely fail to comply with Treasury Department guidelines that require notice to a borrower of the reason for rejecting a HAMP application. Servicers frequently do not offer homeowners the opportunity for a review of HAMP denial decisions. The Congressional Oversight Panel noted in its April 2010 Report that servicers were reporting reasons for only 31% of disqualified or cancelled HAMP modifications.<sup>30</sup> Much of the data the servicers did report was plainly erroneous. For 71% of denials, servicers gave no valid reason. For modification cancellations servicers provided no reason in 72% of cases.<sup>31</sup>

Under the Rhode Island and New York loss mitigation programs, a servicer who wishes to terminate negotiations for cause must state the reasons for this request in filing

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<sup>30</sup> Congressional Oversight Panel: *Evaluating Progress of TARP Foreclosure Mitigation Programs* (April 14, 2010); see also U.S. Government Accountability Office, *Troubled Asset Relief Program, Further Actions Needed to Fully and Equitably Implement Foreclosure Mitigation Programs* GAO 10-634 (June 2010); *Factors Affecting Implementation of the Home Affordable Modification Program* (March 25, 2010); and U.S. Government Accountability Office: *Troubled Asset Relief Program Home Affordable Modification Program Continues to Face Implementation Challenges* (March 2010).

<sup>31</sup> COP Report, p. 54. The COP Report goes on to state: “[T]he panel is deeply concerned about the unacceptable quality of the denial and cancellation reasons and strongly urges Treasury to take swift action to ensure that homeowners are not denied the opportunity for a modification and shuffled off to foreclosure without a servicer at least accounting for why the modification was denied or cancelled.” Among the Panel’s specific recommendations in April 2010 were that Treasury impose “meaningful monetary penalties for non-compliance” with the requirement to refrain from foreclosure until the required review is completed.

with the court. In addition, the parties must file a status report with the court within 60 days of the Loss Mitigation Order indicating the outcome of the negotiations. These procedures encourage transparency in the decision-making process and provide an opportunity for homeowners to obtain information that has thus far eluded homeowners.

**4. Providing Protection from Foreclosure.** HAMP participating servicers are under contractual obligations to consider homeowners for an affordable loan modification before they foreclose. They are required to consider a debtor in an active bankruptcy case for HAMP if a request is made by the debtor, debtor’s counsel, or the case trustee.<sup>32</sup> If a homeowner is found eligible under the HAMP program guidelines and placed on a trial plan, servicers must stop the foreclosure and implement the loan modification.<sup>33</sup> However, the HAMP guidelines do not provide this same protection for homeowners while their application is under consideration. Because the foreclosure units within a servicer operation (and the law firms that handle the foreclosures) often do not communicate with the loss mitigation units handling modification requests, a number of homeowners have had their homes foreclosed while their applications have been pending, only to be told after the sale that they were eligible for a modification.

Bankruptcy Courts’ mediation programs fulfill a much needed role in ensuring that foreclosures do not proceed without consideration of alternatives if requested by the parties. The automatic stay under section 362 of the Bankruptcy Code protects the homeowner at least until the settlement negotiations can be concluded.

**5. Avoiding “Robo-Signer” Abuses by Servicers.** There has been considerable press coverage in recent days concerning servicer abuses in the filing of

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<sup>32</sup> U.S. Treasury Dept. HAMP Supplemental Directive. No. 10-02, p. 7.

<sup>33</sup> U.S. Treasury Dept. HAMP Supplemental Directive. No. 09-01, pp. 6, 2.

false affidavits in foreclosure court proceedings. These affidavits are presented to verify the amounts owed on the mortgage debt and to confirm that the party filing the foreclosure action has standing and is the real party in interest as the holder and owner of the mortgage and note. Depositions in state foreclosure actions have revealed that these “robo-signers” often sign hundreds of affidavits per day attesting to facts not within their personal knowledge, and that the affidavits have not been properly notarized.

This issue is not new to bankruptcy courts. Long before the recent press coverage involving state court proceedings, bankruptcy courts have exposed false affidavit abuses in proceedings often brought by consumer bankruptcy attorneys and judges in these cases have taken appropriate action in response.<sup>34</sup> If there are concerns that a loan modification

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<sup>34</sup> See, e.g., *In re Lee*, 408 B.R. 893 (Bankr. C.D. Cal. 2009) (Rule 9011 sanctions imposed on creditor’s attorney for failure to disclose transfer of ownership of note, failure to join true owner in motion for relief from bankruptcy stay, and for submitting copy of note with motion that was not true and correct copy of the original note); *In re Taylor*, 407 B.R. 618 (Bankr.E.D.Pa. 2009)( local law firm violated Rule 9011 by allowing its attorneys to sign off on electronic filings for stay relief motions prepared by non-attorneys working with national computer data base; finding that proofs of claim filed by national firm were prepared by clerks who are not legally trained and are not paralegals, and that attorney for firm reviews only a random sample of 10 per cent of filed claims), *rev’d*, 2010 WL 624909 (E.D. Pa. Feb. 18, 2010) (setting aside bankruptcy court’s findings of Rule 9011 violations by specific local counsel, but noting concerns about wider LPS practices that were the subject of lengthy critical analysis by bankruptcy court); *In re Cabrera-Mejia*, 402 B.R. 335 (Bankr. C.D. Cal. 2008) (sanctioning law firm under Rule 9011 and Bankr. Rule 105(a) after it filed twenty-one motions for relief from stay with the court without factual investigation and without properly authenticated documents to support claims). *In re Haque*, 395 B.R. 799 (Bankr. S.D. Fla. 2008)(law firm Florida Default Law Group and creditor Wells Fargo jointly and severally sanctioned \$95,130.45 for filing 45 false affidavits related to stay relief motions in which a bogus “penalty interest” fee was charged to debtors); *In re Prevo*, 394 B.R. 847, 851 (Bankr. S.D. Tex. 2008) (reviewing servicers’ practices of inflating proofs of claim with undocumented and excessive fees, court concludes, “[b]ased upon hearings in this and other cases, the Court believes that certain members of the mortgage industry are intentionally attempting to game the system by requesting undocumented and potentially excessive fees and then reducing those fees in amended proofs of claim only after being exposed by debtor’s counsel.”); *In re Stewart*, 391 B.R. 327, 346 (Bankr. E.D. La. 2008)

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

**6. Dealing with Second Mortgages.** A major impediment to loan modifications has been the existence of secondary mortgage loans. Treasury estimates that up to 50 percent of at-risk mortgages have second liens.<sup>35</sup> Many servicers are reluctant to modify a first mortgage if the second mortgage holder does not consent or subordinate its mortgage, and second mortgage holders have not been willing to

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(servicer falsely represented BPO as pass through of a charge of between \$90 and \$125, when it actually paid \$50 for each inspection; servicer also improperly compounded late fees to charge \$360.23 over thirteen months for one \$554.11 missed payment); *In re Parsley*, 384 B.R. 138 (Bankr. S.D. Tex. 2008) (inaccuracies regarding account arrears alleged in motion not detected in part because national default service firm's engagement letter with local law firm specifically prohibited any communication between local firm and its client, the mortgage servicer); *In re Osborne*, 375 B.R. 216 (Bankr. M.D. La. 2007) (attorney sanctioned for filing affidavit alleging debtor defaulted on agreement despite attorney's lack of personal knowledge); *In re Ulmer*, 363 B.R. 777 (Bankr. D.S.C. 2007) (awarding \$33,500 in sanctions and finding that affidavits of default related to motions for relief from stay prepared by out-of-state paralegals were not executed before a notary public and may not have been reviewed and signed by attorney whose signature appeared on the affidavits); *In re Rivera*, 342 B.R. 435 (Bankr. D.N.J. 2006) (\$125,000 sanctions imposed on foreclosure law firm for filing default affidavits in 250 stay relief motions using "blanks" that were pre-signed by employee who no longer worked for servicer), *aff'd*, 2007 WL 1946656 (D.N.J. June 29, 2007); *In re Porcheddu*, 338 B.R. 729 (Bankr. S.D. Tex. 2006) (foreclosure law firm sanctioned for filing false fee applications and misrepresenting that fee statements were based on contemporaneous time records); *In re Brown*, 319 B.R. 876 (Bankr. N.D. Ill. 2005) (\$10,000 sanction imposed on national mortgage servicer for groundless stay relief motion based on false motion); *In re Gorshtein*, 285 B.R. 118 (Bankr. S.D.N.Y. 2002) (sanctions imposed on mortgage creditors and their attorneys for filing motions for stay relief based upon false certifications that debtors had failed to make postpetition payments).

<sup>35</sup> See Dept. of Treasury Making Home Affordable Program Update, April 29, 2009.

cooperate. HAMP attempts to address this problem through its Second Lien Program, but this program has not been successful.

Once again, loan modifications facilitated in a bankruptcy court loss mitigation program may address this problem because all of the liens on the property can be treated by the homeowner at the same time based on a uniform set of laws and valuation standards. If the amount of the second mortgage exceeds the value of the home and the amount of senior mortgages, meaning it is completely “underwater,” the homeowner can propose a Chapter 13 plan that would void or “strip off” the lien and treat the second mortgage as an unsecured debt. Many homeowners in this situation are thus able to resolve the problem of junior mortgages by providing for affordable payments on them during a three to five year Chapter 13 plan.

**7. Dealing with the Homeowner’s Entire Debt Load.** Finally, another problem not addressed by HAMP is that many homeowners are burdened with debt other than their home mortgages. Unable to refinance their homes, many homeowners are struggling to pay off credit card, medical bills, and other non-mortgage debt. This problem is made more acute by the current unemployment situation, with many homeowners experiencing a loss or reduction in family income. The most recent Treasury report shows that after receiving a HAMP loan modification, homeowners on average still have a back-end debt-to-income ratio of 63.3 per cent.<sup>36</sup> While HAMP requires borrowers whose back-end DTI is 55 percent or greater to obtain credit

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<sup>36</sup> See <http://www.financialstability.gov/docs/Sept%20MHA%20Public%202010.pdf>. The back-end DTI is the ratio of total monthly debt payments (including mortgage principal and interest, taxes, insurance, homeowners association and/or condo fees, plus payments on installment debts, junior liens, alimony, car lease payments and investment property payments) to monthly gross income.

counseling, there is no plan to directly assist homeowners in dealing with unmanageable debt. Loan modifications made during a bankruptcy proceeding address this problem because all of the family's financial problems are dealt with under the supervision of a court approved Chapter 13 plan or discharged in a Chapter 7 case. In this way homeowners are far more likely to avoid default on a mortgage modification.

## **Conclusion**

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

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

**2. Clarifying Bankruptcy Code Amendment.** We firmly believe that bankruptcy courts currently possess authority to adopt mediation and loss mitigation

programs under section 105(d) of the Bankruptcy Code, Bankruptcy Rule 7016, and the inherent authority of the courts themselves. However, to avoid any uncertainty and hesitation on the part of local courts to adopt such programs, Congress should consider enacting a clarifying amendment to section 105(d) of the Bankruptcy Code making clear that the courts have authority to set up programs. This would be similar to what was done in 1994 when Congress added subsection (d) to § 105 in order to clarify that the full range of settlement and conference procedures authorized under F.R. Civ. P. 16 are available in bankruptcy cases.

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