

**IDENTIFYING ABUSIVE MORTGAGE MODIFICATION SCHEMES AND
ABUSIVE CREDITOR CONDUCT**

I. WHY IT MATTERS

- a. Statutory duties under 11 U.S.C. § 704
 1. To “collect and reduce to money the property of the estate. . . .”
 - A. Demand letters;
 - B. Turnover motions; and
 - C. Complaints
 2. “investigate the financial affairs of the debtor”
 - A. Appropriate referrals to the UST.
 3. “if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper”
- b. Self-interest
 1. Compensation scheme under the bankruptcy code
 2. Evaluations
 3. Compensation scheme under specific federal and/or state laws
- c. Fiduciary duties: “A Chapter 7 bankruptcy trustee, in his or her official capacity, owes fiduciary duties to the debtor’s estate and its creditors.” *In re Kids Creek Partners, L.P.*, 248 B.R. 554 (Bankr. N.D. Ill. 2000).
 1. Cannot disregard a potential claim when and if one appears
- d. Fairness of the system and prevention of overreaching

II. ABUSIVE MORTGAGE MODIFICATION SCHEMES

a. What are abusive mortgage modification schemes?

1. Schemes designed to defraud.

Common examples include:

A. Refinance schemes – the entity convinces the debtor to stop communicating with the lender and pay the money directly to the entity while the entity negotiates a loan modification with the lender;

E.g.: *Henderson v. Legal Helpers Debt Resolution, L.L.C. (In re Huffman)*, --- B.R. ----, 2014 WL 505261 (Bankr. S.D. Miss. Feb. 6, 2014) (Chapter 7 debtor did not receive “reasonably equivalent value,” within meaning of constructive fraudulent transfer provision, for the \$7,189.75 that she paid prepetition, over first 15 months of debt settlement program, to agency which had agreed to assist her by negotiating at least a 35% reduction in her debts, but which in fact failed to settle a single one of debtor’s debts and applied vast bulk of debtor’s payments over the first 15 months of program, not to negotiating settlements with creditors, but to payment of its fee, despite agency’s contention that its failure to achieve any relief for debtor was entirely the result of debtor’s decision to terminate its services early, before it had built up sufficient pool of funds from debtor’s payments to be able to negotiate a reduction in her debts.).

B. Imposter schemes – the entity holds itself out to be connected with the government and seeks to charge fees to assist the debtor in obtaining relief under a government supported modification/financing program.

E.g.: *Consumer Financial Protection Bureau v. Jalan, et al.*, Case No. 8:12-cv-02088 (C.D. Cal. December 4,

2012) (“Defendants gain consumers’ confidence by misrepresenting that they are a government agency or are approved by or affiliated with the government. For example, one of Defendants’ domain names, makinghomeaffordable.ca, has contained content indistinguishable from . . . makinghomeaffordable.gov, the official webpage of the federal government’s Making Home Affordable program . . .”).

C. Lease/buy-back schemes – the entity buys the debtors home and agrees to sell it back via a rent-to-own or similar arrangement.

E.g.: *Richards v. Cesare*, 901 N.Y.S.2d 910 (N.Y. Sup. 2009) (“The scheme, which frequently targets minority and low-income homeowners, begins when a so-called foreclosure rescue ‘specialist’ locates a susceptible homeowner who is behind in her mortgage payments and whose home may be in foreclosure, and makes promises to ‘save’ her home, lower her monthly payments and repay her outstanding debt only to trick the homeowner into unwittingly signing away her deed to a third party, the ‘straw buyer.’ The foreclosure specialist then arranges for the straw buyer to re-mortgage the property at an amount that typically far exceeds the homeowner’s original mortgage, keeping most of the cash proceeds for himself and his associates.”)

D. Bankruptcy schemes – the entity assists the debtor in filing bankruptcy for the sole purpose of taking advantage of the automatic stay.

E.g.: *In re Jane Brown*, Case No. 13-70356 (Bankr. W.D. Va. Jan. 24, 2014) (Stone, J.) (“The real business of Financial Associates and/or Mr. Jennings, at least as it concerns the Debtor in her cases, rather appears to have been to assist Ms. Brown to obtain a modification of her mortgage loan and that the filing of multiple bankruptcy petitions for the purpose of frustrating the lender’s efforts to foreclose and keep the client in possession of her home

until the loan modification efforts were either successful or exhausted was simply one part of that overall purpose.”)

E. Debt elimination schemes – the entity asserts they can use legal arguments to eliminate the debt.

E.g.: *U.S. v. Jacobs*, 117 F.3d 82 (2d Cir. 1997) (“Jacobs was involved in a so-titled ‘Debt Elimination Program,’ in which unwitting debtors were enticed to purchase ‘certified drafts’ drawn on non-existent financial entities in Mexico. First the targeted debtor would obtain an exact accounting from the creditor to whom the debtor owed money. Then the debtor would give this information to one of Jacobs’ ‘down-line’ distributors along with a fee of about 15% of the total debt owed. In return, the debtor would receive an official-looking, but worthless, piece of paper purporting to be a ‘certified draft,’ drawn on a fictitious financial institution, with a face value equal to the debt owed.”)

F. Dual tracking schemes – where mortgage company pursues foreclosure in spite of accepting and/or encouraging loan modification application.

E.g.: *Young v. CitiMortgage, Inc.*, Case No. 5:12cv079, 2013 WL 3336750 (W.D. Va. July 2, 2013) (Urbanski, J.) (“Dual tracking has been generally described as ‘a common bank tactic’ in which a lender will continue to pursue foreclosure on a defaulted home loan, even while the homeowner has an application pending for loan modification . . . Thus, a borrower whose loan is being ‘dual-tracked’ may believe that her or his application for modification is being considered and not take any steps to avert a foreclosure; then, unbeknownst to the borrower, foreclosure may become imminent, and the borrower’s first indication of the lender’s intention may be, as it was for Young, a foreclosure notice.”)

2. Schemes in violation of applicable laws and government regulations such as the Mortgage Assistance Relief Services Rule issued by the Federal Trade Commission.

A. The Mortgage Assistance Relief Services Rule states that:

- (i) it is illegal to charge upfront fees;
- (ii) the following disclosures must be made – the total cost, that the client can stop using the service at any time, that the entity is not associated with the government, and that the lender may not modify the home loan;
- (iii) the entity must tell the client that their credit rating could be hurt or they could lose their home if you advise them to stop paying the home loan;
- (iv) the entity may not advise the client to stop communicating with the lender;
- (v) the entity must give the client a written notice describing the differences between any proposed modification and the current loan;
- (vi) the entity must tell the client that if the lender's proposed modification is not acceptable to the client, the client does not have to pay the entity's fee; and
- (vii) the entity is prohibited from making any false or unsubstantiated claims.

b. Identifying abusive mortgage modification schemes.

1. Review of bankruptcy petition, schedules, and statements.

- A. Petition – the petition discloses that the debtor has filed multiple cases, often *pro se*.
- B. Schedule A – fractional interest in the real estate.
- C. Schedule B – potential lawsuit.
- D. SOFA – questions 3, 5, 9, and 10.
- E. Statement of assistance.

III. ABUSIVE CREDITOR CONDUCT

a. Examples of abusive creditor conduct.

1. Violations of mortgage servicing rules established by the Consumer Financial Protection Bureau (“CFPB”) (effective January 10, 2014 – a summary of the final rules is in the Appendix). The rules relate to, among other things:

a. Prompt crediting of payments.

b. Payoff requests within 7 days of written requests.

c. Charging for force-placed insurance unless (i) there is a reasonable basis to believe the property is uninsured and (ii) the servicer has provided a notice 45 days before charging for the coverage, with a reminder 30 days after the initial notice and at least 15 days before charging the debtor. If the debtor has an escrow account and the lender can continue the homeowner’s policy, the lender must do so even if it has to advance funds to the escrow account.

d. “Dual tracking.” Prevents Servicer from issuing the first notice or filing for foreclosure until a loan is more than 120 days behind. Provides specific requirements with respect to a Servicer’s conduct where a borrower submits an application for loss mitigation, even if the loan is more than 120 days behind.

2. Violations of the National Mortgage Settlement reached with Ally/GMAC, Bank of America, Citi, JPMorgan Chase, and Wells Fargo.

A. Full settlement agreements available at www.nationalmortgagesettlement.com/about

B. Significant terms include:

1. Proofs of Claim (“POC”). Servicer shall ensure that POCs filed on behalf of Servicer are documented in accordance with the United States Bankruptcy Code, the Federal Rules of Bankruptcy Procedure, and any applicable local rule or order (“bankruptcy law”). Unless not permitted by statute or rule, Servicer shall ensure that each POC is documented by attaching:

a. The original or a duplicate of the note, including all indorsements; a copy of any mortgage or deed of trust securing the notes (including, if applicable, evidence of recordation in the applicable land records); and copies of any assignments of mortgage or deed of trust required to demonstrate the right to foreclose on the borrower’s note under applicable state law (collectively, “Loan Documents”). If the note has been lost or destroyed, a lost note affidavit shall be submitted.

b. If, in addition to its principal amount, a claim includes interest, fees, expenses, or other charges incurred before the petition was filed, an itemized statement of the interest, fees, expenses, or charges shall be filed with the proof of claim (including any expenses or charges based on an escrow analysis as of the date of filing) at least in the detail specified in the current draft of Official Form B 10 (effective December 2011) (“Official Form B 10”) Attachment A.

c. A statement of the amount necessary to cure any default as of the date of the petition shall be filed with the proof of claim.

d. If a security interest is claimed in property that is the debtor’s principal residence, the attachment prescribed by the appropriate Official Form shall be filed with the proof of claim.

e. Servicer shall include a statement in a POC setting forth the basis for asserting that the applicable party has the right to foreclose.

f. The POC shall be signed (either by hand or by appropriate electronic signature) by the responsible person under penalty of perjury after reasonable investigation, stating that the information set forth in the POC is true and correct to the best of such responsible person's knowledge, information, and reasonable belief, and clearly identify the responsible person's employer and position or title with the employer.

2. Motions for Relief from Stay ("MRS"). Unless not permitted by bankruptcy law, Servicer shall ensure that each MRS in a chapter 13 proceeding is documented by attaching:

a. To the extent not previously submitted with a POC, a copy of the Loan Documents; if such documents were previously submitted with a POC, a statement to that effect. If the promissory note has been lost or destroyed, a lost note affidavit shall be submitted;

b. To the extent not previously submitted with a POC, Servicer shall include a statement in an MRS setting forth the basis for asserting that the applicable party has the right to foreclose.

c. An affidavit, sworn statement or Declaration made by Servicer or based on information provided by Servicer ("MRS affidavit" (which term includes, without limitation, any facts provided by Servicer that are included in any attachment and submitted to establish the truth of such facts) setting forth:

i. whether there has been a default in paying pre- petition arrearage or post-petition amounts (an “MRS delinquency”);

ii. if there has been such a default, (a) the unpaid principal balance, (b) a description of any default with respect to the pre-petition arrearage, (c) a description of any default with respect to the post- petition amount (including, if applicable, any escrow shortage), (d) the amount of the pre-petition arrearage (if applicable), (e) the post-petition payment amount , (f) for the period since the date of the first post-petition or pre-petition default that is continuing and has not been cured, the date and amount of each payment made (including escrow payments) and the application of each such payment, and (g) the amount, date and description of each fee or charge applied to such pre-petition amount or post-petition amount since the later of the date of the petition or the preceding statement pursuant to paragraph III.B.1.a; and

iii. all amounts claimed, including a statement of the amount necessary to cure any default on or about the date of the MRS.

d. All other attachments prescribed by statute, rule, or law.

e. Servicer shall ensure that any MRS discloses the terms of any trial period or permanent loan modification plan pending at the time of filing of a MRS or whether the debtor is being evaluated for a loss mitigation option.

3. For all creditors, inaccurate, incomplete, or duplicate proofs of claim.

A. Proofs of claim for discharged debts.

i. Capital One Bank (USA), N.A. suit and settlement. Capital One filed 5,600 proofs of claim in various cases attempting to collect debts subject to prior discharge orders. The UST filed suit and a stipulated order was entered, among other things, requiring Capital One to hire an auditor, withdraw “Erroneous Claims,” and refund certain distributions.

4. For all creditors, inaccurate or incomplete motions for relief.