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ADR'S PLACE IN FORECLOSURE: REMEDYING THE FLAWS OF A SECURITIZED HOUSING MARKET

Lydia Nussbaum[†]

Millions of Americans lost their homes during the foreclosure crisis, an unprecedented disaster still plaguing local and national economies. A primary factor contributing to the crisis has been the failure of conventional foreclosure procedures to account for the new realities of securitization and the secondary mortgage market, which transformed the traditional borrower-lender relationship. To compensate for the shortcomings of conventional foreclosure procedures and stem the tide of residential foreclosure, state and local governments turned to ADR processes for a solution. Some foreclosure ADR programs, however, have greater potential to avoid foreclosures than others. This Article comprehensively examines the key components of foreclosure ADR programs and presents best practices for governments seeking to utilize ADR as a tool to mitigate the foreclosure crisis and re-energize the economy.

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INTRODUCTION

As the foreclosure crisis unfolded, causing millions of people to lose their homes and trillions of dollars in real estate investments to evaporate, much came to light about the metamorphosis of the mortgage industry between the early 1990s and 2008. Without much public attention, brand new markets and industries were born. The proliferation of new products like mortgage-backed securities that investment banks could now legally buy, sell, and repackage spawned a secondary mortgage market that never before existed. Homeowners' mortgages were not sitting on the books of their local savings and loan; instead, they were bundled, sliced, and sold in slivers to unknown investors around the world.

The foreclosure crisis also exposed the inadequacy of conventional foreclosure proceedings, given how dramatically the mortgage industry had changed. Typical judicial and nonjudicial foreclosure proceedings assume a direct relationship between borrower and lender that, post securitization, no longer exists for the vast majority of mortgages. This

changed relationship, when combined with an unprecedented volume of cases and a collapsed housing market, compromised the integrity of the entire foreclosure process.

In response, state and local governments¹ instituted a variety of public policy interventions designed to slow foreclosure rates, stop unnecessary foreclosures, and help homeowners remain in their homes.² These programs were instituted because the loss of homeowners and subsequent erosion of communities posed, and continues to pose, the greatest threat to economic stability across the country.³ However, in order to keep homeowners in their homes and avert further economic catastrophe, the problematic relationship between homeowners, investors, and third-party loan servicers had to be overcome.

To overcome this challenge, many state and local governments turned to alternative dispute resolution (ADR) processes. Foreclosure ADR programs have the potential to address the problems of securitization by establishing direct communication between a homeowner and a decision-maker with the authority to undertake an alternative to foreclosure. These programs modify conventional legal procedures for residential mortgage foreclosure by incorporating an ADR process such as mediation, conciliation, or a facilitated settlement negotiation meeting.⁴ Including an ADR process as a compulsory step in foreclosure gives the homeowner a right to negotiate with the loan

¹ The federal government also instituted programs, but these applied to the macro level, primarily addressing government and financial institutions at the heart of the mortgage and housing industries. While not the focus of this Article, these federal programs are discussed in greater detail below. See *infra* note 81.

² Programs include protecting consumers from foreclosure "rescue" scams, connecting borrowers to housing counselors, assisting homeowners with refinancing, slowing the foreclosure process, banning common predatory loan practices, adopting regulatory guidelines for subprime and nontraditional mortgage products, educating homebuyers, helping first time home buyers purchase foreclosed properties, improved enforcement of mortgage fraud and lending laws, and heightened regulation of mortgage brokers and loan originators. For a complete list of state legislation, see *Foreclosures Publications and Resources*, NAT'L CONFERENCE OF STATE LEGISLATURES, <http://www.ncsl.org/issues-research/banking/foreclosures-publications-and-resources.aspx> (last updated Jan. 4, 2012).

³ FED. RESERVE SYS., THE U.S. HOUSING MARKET: CURRENT CONDITIONS AND POLICY CONSIDERATIONS (2012), available at <http://federalreserve.gov/publications/other-reports/files/housing-white-paper-20120104.pdf>. A 2009 study by the Urban Institute, citing a report prepared for the U.S. Senate Joint Economic Committee, states that the estimated total cost of a single foreclosure is \$79,443, which includes cost to the homeowner (\$7200), costs incurred by the lender or loan servicer (\$50,000), cost to local government (\$19,229), and costs to neighbors adjacent to the foreclosed property (\$3016). G. THOMAS KINGSLEY, ROBIN SMITH & DAVID PRICE, URBAN INSTITUTE, THE IMPACTS OF FORECLOSURES ON FAMILIES AND COMMUNITIES 21 (2009), available at http://www.urban.org/UploadedPDF/411909_impact_of_foreclosures.pdf.

⁴ Both mediation and conciliation bring disputing parties together with a third party who helps the parties identify issues, overcome communication barriers, and explore possible options for resolving the dispute. Both processes are unantagonistic and, unlike settlement, do not require a lawsuit, though conciliation is usually less structured than in mediation. 4 AM. JUR. 2D *Alternative Dispute Resolution* §§ 4-6 (2012).

servicer, a third party new to the residential mortgage landscape, and also provides for some oversight of the loan servicer's decision-making. Each jurisdiction has served as a laboratory, developing programs tailored to local needs and experimenting with different ways to use ADR processes in foreclosure proceedings. ADR programs have proven remarkably effective in many jurisdictions but some approaches have more impact than others.

This article comprehensively examines the characteristics of these state and local government programs and presents suggestions for best practices. Currently, many states are considering including ADR as a permanent part of foreclosure proceedings and the Uniform Law Commission is in the process of drafting model legislation to include ADR in residential mortgage foreclosure processes.⁵ This article is intended to guide lawmakers and consumer advocates toward those approaches most likely to mitigate the foreclosure crisis and re-energize the economy.

The first part of this article explains why the conventional foreclosure process proved ill equipped to respond to the foreclosure crisis. It explains how securitization changed the relationship between homeowners and lenders by introducing a new third-party loan servicer. This changed relationship, compounded by an unprecedented volume of foreclosures and a collapsed housing market, overwhelmed the existing legal procedures for foreclosure, necessitating the need for an alternative process. The second part of this article examines why foreclosure ADR programs are a useful tool for state and local governments seeking to respond to the foreclosure crisis. By bringing homeowners and loan servicers together for a structured negotiation about the loan, foreclosure ADR programs can help prevent uneconomical foreclosures. The third part examines key components of foreclosure ADR programs and identifies best practices. In examining how these programs differ, this article is able to present options for creating, implementing, and structuring a foreclosure ADR program and identify which options are most likely to alleviate the effects of the foreclosure crisis. The article concludes with some observations about foreclosure mediation programs and calls for more thorough and systematic assessment of their impact in resolving foreclosure cases and buoying local housing markets.

⁵ *Residential Real Estate Mortgage Foreclosure Process and Protections*, UNIF. LAW COMM'N, <http://uniformlaws.org/Committee.aspx?title=Residential%20Real%20Estate%20Mortgage%20Foreclosure%20Process%20and%20Protections> (last visited Feb. 19, 2013).

I. INADEQUACY OF CONVENTIONAL FORECLOSURE PROCEDURES

This section begins by examining conventional foreclosure procedures and their origins in the primary mortgage market. It then argues that these conventional foreclosure procedures failed to account for new players created by securitization and the secondary mortgage market. These new players changed the way in which foreclosure decisions were made. As a result, when the foreclosure crisis began, homeowners and investors lacked adequate procedural protections, deepening the crisis and causing the housing market and national economy to suffer.

A. *Conventional Foreclosure Procedure*

Conventional legal foreclosure procedure dates from a time when there was a direct relationship between borrowers and lenders. To finance a home, a borrower would go to a local savings and loan and request a home loan.⁶ The savings and loan would issue a loan and, in return, the homeowner would sign a promissory note granting the savings and loan a mortgage interest in the house as collateral. The lender kept the loan on its books and took care of managing the loan, sending out monthly billing statements and collecting payments. A homeowner's failure to make loan payments as agreed upon would enable the savings and loan to exercise its right to take title of the property, a legal remedy provided to lenders.

In a conventional borrower-lender relationship, when a loan became delinquent the lender had two options. A lender could decide to foreclose on the loan, take title of the property, and sell it or it could pursue a loss mitigation "workout."⁷ A lender had to conduct a cost-benefit analysis to determine which option was more likely to yield the greatest value. While selling the property at a foreclosure sale to the highest bidder could allow the lender to get its money back quickly, a lender who foreclosed assumed full responsibility for maintaining the property and also ran the risk that the amount of the loan would not be recovered at auction. If the lender could work with the borrower to cure the delinquent loan, thereby keeping the homeowner in the home and continuing to make monthly payments, then the lender stood to recoup

⁶ Savings and loan associations, unlike commercial banks, are cooperatives that hold members' savings deposits and pay interest on them, as well as provide home mortgage loans. Savings and loans became the primary source of home loans in the United States after the Great Depression through the Federal Home Loan Bank Act of 1932.

⁷ DARRYL E. GETTER ET AL., CONG. RESEARCH SERV., RL 34232, THE PROCESS, DATA, AND COSTS OF MORTGAGE FORECLOSURE 1 (2008).

more money in the long run because it could collect the principal plus interest.

Homeowners and lenders in this conventional relationship knew each other and both had financial stakes in the same community. When it came to handling a delinquent loan, there was a need for an individualized assessment—especially in a weak housing market—and lenders had to consider carefully which of these options made the most financial sense.

If a lender chose to foreclose, then it had to follow the foreclosure process codified in state statutes. States employ two types of conventional foreclosure proceedings. Some jurisdictions use a judicial foreclosure process that requires a court to review evidence and approve a lender's foreclosure petition before the lender can proceed with a forced sale of the mortgaged property. Other states employ nonjudicial foreclosure, also called power-of-sale or statutory foreclosure, that does not direct foreclosure proceedings through the courts. Instead, the foreclosure happens privately between the parties. The lender must satisfy statutory requirements for notice, documentation, and various waiting periods before it can take legal title of the property and proceed with sale at a foreclosure auction.⁸ Many states permit both types of foreclosure proceedings but most primarily use one type.⁹ Because judicial foreclosure requires opening a civil suit and attending a judicial hearing, the process of foreclosing on a property in a judicial foreclosure state takes longer¹⁰ and is more costly for lenders. Additionally, some states also provide borrowers with a statutory right of redemption, or a period of time during which the borrower can recover the property if he provides the lender with the full amount bid at the foreclosure sale plus additional costs.¹¹

If, in the alternative, a conventional lender chose to pursue loss mitigation, then it would have to determine whether, with a few

⁸ *Id.* at 2. The auction proceeds after complying with notice requirements, typically advance notice to the homeowner and detailed advertisements in local news media.

⁹ ANDREW JAKABOVICS & ALON COHEN, CTR. FOR AM. PROGRESS, IT'S TIME WE TALKED: MANDATORY MEDIATION IN THE FORECLOSURE PROCESS 2 (2009), available at http://www.americanprogress.org/wp-content/uploads/issues/2009/06/pdf/foreclosure_mediation.pdf.

¹⁰ National Public Radio's Planet Money team found that, between 2006 and 2010, the time for non-judicial foreclosure increased from roughly 130 to 200 days (more than two months) and the time for judicial foreclosure increased from roughly 145 to 271 days (more than four months). David Kestenbaum, *How Long Does Foreclosure Take?*, NAT'L PUB. RADIO (Oct. 26, 2010, 12:57 PM), <http://www.npr.org/blogs/money/2010/10/26/130833818/foreclosure>.

¹¹ Prentiss Cox, *Foreclosure Reform Amid Mortgage Lending Turmoil: A Public Purpose Approach*, 45 HOUS. L. REV. 683, 702 (2008). The National Consumer Law Center surveyed U.S. foreclosure laws and produced a report finding a basic lack of due process protections. JOHN RAO & GEOFF WALSH, NAT'L CONSUMER LAW CTR., FORECLOSING A DREAM: STATE LAWS DEPRIVE HOMEOWNERS OF BASIC PROTECTIONS (2009), available at <http://www.nclc.org/images/pdf/pr-reports/report-foreclosing-dream.pdf>.

adjustments, a delinquent borrower could cure the loan and continue making monthly payments. Loss mitigation includes a variety of plans to reduce borrowers' monthly payments, allowing them to remain in their homes and continue making payments on the loan. Some examples of loss mitigation plans include: 1) forbearance, when loan payments are temporarily delayed; 2) a repayment plan, which allows homeowners to pay a little extra each month to make up for any missed payments in the past; 3) permanently restructuring a loan by extending the time over which the loan must be repaid, changing the interest rate, reducing the balance of the outstanding principal, or adding the delinquent interest amount to unpaid principal balance; and, in some instances, 4) refinancing the home and issuing a new loan altogether.¹²

A conventional lender could also explore a "non-retention" plan with a borrower who was still unable to make payments under a loss mitigation plan. Under a non-retention plan, the borrower forfeits the property directly to the lender in a way that minimizes the borrower's financial hardship and saves the lender the trouble of arranging a foreclosure sale. These non-retention plans include having the lender agree to a short sale¹³ or accept a deed in lieu of foreclosure.¹⁴ Of course, the borrower can always sell the home to pay off the mortgage in full. But, a weak housing market can render the current market value of the home too low to pay off the mortgage.¹⁵ This situation proves troublesome for both the borrower and the lender because the asset used as collateral for the mortgage loan is no longer valuable enough to allow both parties to walk away from the loan arrangement without significant loss—neither the borrower nor the lender can sell the home to pay off the loan.

In determining whether to pursue a foreclosure alternative, a financially motivated conventional lender will select the option that minimizes losses.¹⁶ This kind of cost-benefit analysis requires close

¹² Larry Cordell et al., *The Incentives of Mortgage Servicers: Myths and Realities* 7 (Fed. Reserve Bd., Working Paper No. 2008-46, 2008), available at <http://www.federalreserve.gov/pubs/feds/2008/200846/200846pap.pdf>.

¹³ In a short sale, the lender or loan servicer agrees to accept the proceeds from a sale of the home in satisfaction of the loan, even if the proceeds are less than the amount owed. However, some lenders may still attach a judgment lien against the borrower for the deficiency. SAMUEL FRUMKIN ET AL., U.S. DEPT OF THE TREASURY, FORECLOSURE PREVENTION: IMPROVING CONTACT WITH BORROWERS 7 (2007), available at <http://www.occ.gov/topics/community-affairs/publications/insights/insights-foreclosure-prevention.pdf>.

¹⁴ A deed in lieu of foreclosure is a workout in which the borrower voluntarily conveys clear property title to the lender in return for a discharge of the debt. This is generally used when the house has been on the market unsuccessfully for a considerable time. Deeds in lieu of foreclosure and short sales may be complicated if there are secondary lien holders. *Id.* at 8.

¹⁵ See *infra* note 58 on meaning of "underwater" and "overleveraged."

¹⁶ In 2007, it was estimated that a lender could lose around \$50,000 per foreclosure. JOINT ECON. COMM., SHELTERING NEIGHBORHOODS FROM THE SUBPRIME FORECLOSURE STORM 14 (2007), available at <http://www.jec.senate.gov/archive/Documents/Reports/subprime11apr2007>

contact with the borrower in order to assess the borrower's financial circumstances and ability to continue making future payments. It also requires specialized knowledge of the local housing market, the lender's liquidity, mortgage financing and research capabilities in order to make a sound business judgment as to which loss mitigation or non-retention plan makes the most economic sense for the lender.¹⁷

B. *Foreclosure in Securitized Framework*

A secondary mortgage market superseded the primary mortgage market that allowed for direct relationships between borrowers and lenders. Although this new market introduced new players, legal foreclosure procedures remained the same.¹⁸

The secondary mortgage market developed in the late 1970s, when the baby-boom generation began to buy houses and economists worried that the savings and loan industry lacked sufficient capital to fund all of their mortgages.¹⁹ To address the problem, the federal government created Freddie Mac to buy up mortgages from savings and loans, allowing those savings and loans to free up capital and make more mortgages.²⁰ The federal government then converted the mortgage interest into a bond, or security, that it could sell to third-party investors

revised.pdf. But that dollar figure accounts only for direct costs of managing a foreclosed property and excludes the indirect loan servicing costs for investors of a securitized mortgage, such as attorneys fees to shepherd the case through the foreclosure process.

¹⁷ Cordell et al., *supra* note 12, at 15–16.

¹⁸ Direct, borrower-lender loans constitute the primary mortgage market while the secondary mortgage market consists of mortgage-backed securities and those who trade and invest in them. Estimates of how many first lien residential mortgages have been securitized vary but may be as high as ninety percent. Adam J. Levitin & Tara Twomey, *Mortgage Servicing*, 28 YALE J. ON REG. 1, 12 (2011).

¹⁹ BETHANY MCLEAN & JOE NOCERA, *ALL THE DEVILS ARE HERE: THE HIDDEN HISTORY OF THE FINANCIAL CRISIS* 5 (2010). At the same time it faced an increased demand to provide capital to new homeowners, the savings and loan industry was losing capital because of high inflation, high interest rates, newly created investment vehicles, and no way to access a broader pool of funds. *Id.* Additionally, the Community Reinvestment Act, in an effort to combat redlining and help minority and low-income families achieve homeownership, required banks to extend credit to individuals who never before qualified for loans. Community Reinvestment Act of 1977, Pub. L. No. 95-128, § 802, 97 Stat. 1111, 1147 (codified at 12 U.S.C. § 2901 (2012)). This further increased the pool of borrowers in search of home loans. *Id.*

²⁰ MCLEAN & NOCERA, *supra* note 19, at 7. This was not the first time the federal government rode to rescue: during the Great Depression, when property values declined by 50% and financial institutions were unable to resell foreclosed properties, the federal government produced an entire secondary mortgage market by creating new entities, like Fannie Mae and the Federal Housing Administration, to buy up and insure mortgages from struggling lenders. For a more complete history of the American mortgage market and the development of modern mortgage products, see Richard K. Green & Susan M. Wachter, *The American Mortgage in Historical and International Context*, 19 J. ECON. PERSPECTIVES 93, 94–100 (2005).

on Wall Street.²¹ Passage of federal legislation in the 1980s loosened regulations on the secondary mortgage market,²² allowing for creation of new securities derivatives and participation of private investment firms,²³ which resulted in an explosion in the secondary mortgage market.²⁴

The shift from a primary to a secondary mortgage market changed the borrower-lender relationship in two fundamental ways. First, securitization eliminated the single lender entity that was both financially invested in the performance of a loan and able to negotiate directly with the borrower, and replaced it with an array of anonymous investors. Second, once a homeowner's mortgage was sold and repackaged on the secondary mortgage market as a security, the responsibility for managing the loan rested not with the loan originator but with a third party.²⁵ This third party, called a loan servicer, was

²¹ MCLEAN & NOCERA, *supra* note 19, at 5, 7.

²² Secondary Market Mortgage Enhancement Act of 1984, Pub. L. No. 98-440, § 105, 110 Stat. 1689, 1691 (amending 12 U.S.C. §§ 24, 1464(c)(1), 1757) (expanding the mortgage-backed securities into the private sector by allowing entities other than government sponsored enterprises (Fannie Mae and Freddie Mac) to create mortgage-backed securities products); Tax Reform Act of 1986, Pub. L. No. 99-514, § 671, 100 Stat. 2085, 2308-18 (codified at 26 U.S.C. § 860A (2012)) (stopping multi-class securities, or tranching securities, from double taxation).

²³ With securitization, lenders could sell the loan to investment banks. These banks created and marketed to investors a variety of products derived from mortgage backed securities. Now, instead of having to purchase an entire mortgage-backed security, investors could choose to buy derivatives, or slices, of the bond based on how much risk the investors wanted to assume. For a more detailed explanation of some derivative types, see Green & Wachter, *supra* note 20, at 107-08 (citing FRANK J. FABOZZI, *THE HANDBOOK OF MORTGAGE-BACKED SECURITIES* (2001)). See also Levitin & Twomey, *supra* note 18, at 21, for a description of how tranching creates a hierarchy among investors based on default risk.

²⁴ Bonds created from mortgages on single-family homes grew from zero to more than \$350 billion between 1970 and 1981, and by the end of 2001 were worth more than \$3.3 trillion. MCLEAN & NOCERA, *supra* note 19, at 8.

²⁵ Levitin & Twomey, *supra* note 18, at 11. Levitin and Twomey provide a systematic overview of the residential mortgage servicing business and how it differs from the traditional portfolio lender business. Federal Reserve Board Governor Sarah Bloom Raskin offered the following perspective:

Before securitization became commonplace, it was much more likely for a mortgage to be serviced by the same entity that had originated the loan. This simple approach ensured that lenders knew immediately if a homeowner was having payment problems, and could take action to mitigate possible losses. A fair bit of this kind of "portfolio servicing" still takes place, but as the residential real estate market shifted from an originate-to-hold model to an originate-to-distribute model, an industry of independent third-party entities emerged to service the loans on behalf of the securitization trusts. These trusts, as a requirement for their tax-preferred status, were supposed to be passive, with the management of individual loans left to the servicer. These servicing arrangements are now commonplace in the industry: In fact, the system has matured rapidly and experienced considerable consolidation over the past twenty years.

Sarah Bloom Raskin, Remarks at the National Consumer Law Center's Consumer Rights Litigation Conference (Nov. 12, 2010), available at <http://www.federalreserve.gov/newsevents/speech/raskin20101112a.htm>.

hired by the investor trust to manage the loan account in the investors' best interests.²⁶ Thus, with securitization, a triangulated relationship between borrower, investors, and third-party loan servicer supplanted the direct borrower-lender relationship.

As agents of investors, loan servicers have considerable responsibility for managing a loan. The loan servicer issues monthly statements, collects the homeowner's payments, places funds into escrow accounts for taxes and insurance, remits funds to the investors,²⁷ calculates interest rate adjustments for adjustable rate mortgages (ARMs), and reports to borrower credit information to national credit bureaus.²⁸ The loan servicer also serves as the homeowner's only contact for any and all questions relating to paying back the loan. Finally, the loan servicer is responsible for conducting the cost-benefit analysis for delinquent loans and determining which option—pursuing foreclosure or working out an alternative arrangement with the borrower—minimizes the investors' losses. If the loan servicer pursues foreclosure then it takes responsibility for adhering to the foreclosure laws of the jurisdiction, hiring an attorney to file a foreclosure action in a judicial foreclosure jurisdiction or follow the foreclosure notice and filing instructions required by statute in nonjudicial foreclosure jurisdictions.

C. *Problems with Securitized Loan Servicing*

In theory, entrusting the responsibility for managing a loan to a third party is practical, but in practice it has proven problematic. Because of how the loan servicing industry is structured, loan servicers are incentivized to foreclose rather than engage in a cost-benefit analysis to determine the option that would most benefit investors' financial

²⁶ Levitin & Twomey, *supra* note 18, at 16. Securitization separates the ownership (having legal title) from the management of mortgage loans. The trust, from which investors have bought mortgage-backed securities, holds legal title to the mortgage. The loan servicer, usually a third-party agent, is contractually responsible for acting on behalf of the investors by collecting payments and passing along principal and interest payments to investors. MORTG. BANKERS ASS'N, LENDERS' COST OF FORECLOSURE 3 (2008), available at <http://www.mbaa.org/files/Advocacy/2008/LendersCostofForeclosure.pdf>.

²⁷ The mortgagor payments are usually passed along to a trust that in turn distributes funds to investors. Levitin & Twomey, *supra* note 18, at 23.

²⁸ The loan servicing industry is largely unregulated and the unfolding of the foreclosure crisis revealed many flaws, from predatory practices (padding of fees, strategic misapplication of payments, and inaccurate assessment of homeowners' insurance) to conflicts of interest for mega-servicers that are also investors in the mortgages they manage, and the robo-signing scandal. See *Problems in Mortgage Servicing from Modification to Foreclosure: Hearing Before the S. Comm. on Banking, Hous., and Urban Affairs*, 111th Cong. 53, 54–55 (2010) (statement of Thomas J. Miller, Attorney General, State of Iowa) [hereinafter *Problems in Mortgage Servicing Hearing*], available at <http://www.gpo.gov/fdsys/pkg/CHRG-111shrg65258/pdf/CHRG-111shrg65258.pdf>; *id.* at 358–60 (statement of Daniel K. Tarullo, Member, Board of Governors of the Federal Reserve System); Raskin, *supra* note 25.

interests. As a consequence, little communication occurs between loan servicers and borrowers. This is especially problematic when a loan is delinquent and communication is critical to determine whether foreclosure is the best option.

1. Loan Servicer Preference for Foreclosure

Loan servicers prefer foreclosure for two main reasons. The first involves the automated way in which loan servicers conduct business. The transactional part of loan servicing, sending out billing statements and collecting payments, is an automated process that can be done at minimal cost and with minimal human intervention.²⁹ The problem is that even managing defaulted loans is highly automated so that the cost-benefit analysis once conducted by a loan agent at the savings and loan is replaced by computer software. The loan servicer enters a code indicating that a loan is delinquent and the computer automatically selects a previously approved attorney, generates and uploads the documents required for filing the foreclosure, and forwards them to the attorney.³⁰ Once the property is foreclosed and liquidated, the servicer automatically bills the investor entity for the cost of the foreclosure.³¹ As a result of automation, loan servicing companies have few people on the payroll with the requisite knowledge and skills to conduct loss mitigation or non-retention analysis for an individual borrower's loan.

Secondly, loan servicers rely on foreclosure instead of other loss mitigation tactics because of the loan servicing industry's business model. Loan servicers make their profit by maximizing the fees earned from managing the loan and minimizing associated costs, hence automation.³² Servicers rarely have an ownership interest in the loan

²⁹ *The Foreclosure Crisis: Hearing Before the H. Comm. on Oversight and Gov't Reform*, 112th Cong. 47, 51 (2011) (statement of Mark A. Kaufman, Commissioner of Financial Regulation, State of Maryland) [hereinafter *Foreclosure Crisis Hearing*], available at <http://oversight.house.gov/wp-content/uploads/2012/04/3-8-11-Full-Committee-Hearing-Transcript.pdf>. Levitin and Twomey report that the annual cost of servicing a single, current loan, not including technology investment or corporate overhead, is between \$36–\$47 per loan. Levitin & Twomey, *supra* note 18, at 25 (citing Amy Crews Cutts & Richard K. Green, *Innovative Servicing Technology: Smart Enough to Keep People in Their Houses?* 4 (Freddie Mac, Working Paper No. 04-03, 2004), available at http://www.freddiemac.com/news/pdf/fmwp_0403_servicing.pdf).

³⁰ *In re Taylor*, 407 B.R. 618, 627 (Bankr. E.D. Pa. 2009), *rev'd*, 2010 WL 624909 (E.D. Pa. 2010), *aff'd in part, rev'd in part*, 655 F.3d 274 (3d Cir. 2011).

³¹ When a loan goes into delinquency, the servicer has to make advances of principal and interest to the investors, whether or not payments from the borrower are received. The servicer also covers the cost of taxes, insurance, property preservation, inspection and legal costs. These advance costs are reimbursed after the foreclosure is completed. FRUMKIN, *supra* note 13, at 3; Raskin, *supra* note 25.

³² Levitin & Twomey, *supra* note 18, at 5. Such fees include a percentage of the unpaid balance, fees charged to borrowers, interest income on borrower payments, and any business

and therefore do not stand to lose money if the loan fails.³³ In fact, loan servicers lose money if poor performing loans are kept on their books. If a loan is delinquent, then the servicer usually has to advance interest, and possibly principal payments, to the investor trust.³⁴ The loan servicer is then reimbursed for these payment advances after the foreclosed property is liquidated. There is little room in this financial structure for the cost-benefit analysis needed for loss mitigation, which requires loan servicers to pay fixed overhead costs and out-of-pocket expenses that may not be recouped from the investor trust.³⁵ As a result, servicers' incentives are not completely aligned with investors' interests; servicers will favor options that are less labor intensive and require little cost upfront, such as foreclosure, even if a more labor intensive option, such as modification, better preserves investors' interests.³⁶ Whether or not a specific loan servicer is incentivized to foreclose or not depends on the servicing agreement between the loan servicer and the investor trust.³⁷ Therefore, each loan servicer must make a different assessment when deciding whether to foreclose or whether to consider seriously a homeowner's request for loss mitigation analysis.³⁸

arrangements connected to the loan servicer, such as insurance, property valuation, and inspection. DIANE E. THOMPSON, NAT'L CONSUMER LAW CTR., WHY SERVICERS FORECLOSE WHEN THEY SHOULD MODIFY AND OTHER PUZZLES OF SERVICER BEHAVIOR: SERVICER COMPENSATION AND ITS CONSEQUENCES 2-5 (2009), available at <http://www.macdc.org/research/Servicer-Report1009.pdf>.

³³ THOMPSON, *supra* note 32, at 1.

³⁴ *Id.* at 26 (providing examples of loan servicers who had to make advancements, such as Prospectus Supplement, IndyMac, MBS, Depositor, Indymac INDX Mortgage Loan Trust 2007-FLX5).

³⁵ These costs, estimated to be \$750-\$1000 go into the time required to contact borrowers, collect and verify data, obtain home value estimates, determine whether the borrower's setback is temporary or permanent, coordinate with any second-lien holders, and estimate the net present value of the loan for each loss mitigation alternative. Generally, out-of-pocket expenses can be charged to investors, but not overhead for the loan servicer staff conducting the analysis. See *id.* at 27; Cordell et al., *supra* note 12, at 15-17.

³⁶ Cordell et al., *supra* note 12, at 7, 18. Another complicating factor is that some investors with an interest in a loan may be better served by foreclosure and other investors with an interest in the same loan may be better served by loan modification. EDWARD VINCENT MURPHY, CONG. RESEARCH SERV., RL 34386, COULD SECURITIZATION OBSTRUCT VOLUNTARY LOAN MODIFICATIONS AND PAYMENT FREEZES? 5 (2008); Cordell, *supra* note 12, at 21-22.

³⁷ Depending on the terms of the servicing agreement, loan servicers can have significant leeway or can be quite restricted as to the extent to which they can modify the homeowner's loan agreement.

³⁸ While many servicers are capable of making affordable loan modifications, the largest servicers such as Bank of America, JP Morgan Chase, and Wells Fargo proved unwilling to do so on a large enough scale to impact long term foreclosure trends. Among these large servicers, some approved modifications at rates two to three times higher than other servicers. GEOFF WALSH, NAT'L CONSUMER LAW CTR., REBUILDING AMERICA: HOW STATES CAN SAVE MILLIONS OF HOMES THROUGH FORECLOSURE MEDIATION 5 (2012), available at http://www.nclc.org/images/pdf/foreclosure_mortgage/mediation/report-foreclosure-meditation.pdf.

2. Communication Failures Between Borrowers and Loan Servicers

A fundamental lack of communication and transparency is an additional obstacle for borrowers seeking to avoid foreclosure. Because loan servicing is primarily automated, much of its business has been outsourced overseas, with representatives reachable only by fax or phone.³⁹ The industry is notorious for its lack of customer service, further fueling the confusion that abounded with the escalation of the foreclosure crisis. Anecdotes abound⁴⁰ of homeowners who spent over a year submitting and resubmitting loan modification applications, only to discover that the applications were lost or improperly denied,⁴¹ or that a foreclosure sale had already been scheduled.⁴² Homeowners requested loan modifications only to be offered a plan with higher monthly payments than the original⁴³ or, after successfully completing temporary modification plans, homeowners waited in limbo for months to receive a final modification plan but then were inexplicably denied.⁴⁴ Sometimes the reasons for the denials were not the fault of the homeowner: paperwork and documents were lost, loan servicers did not comply with their promised time frames for reviewing modification

³⁹ *Problems in Mortgage Servicing Hearing*, *supra* note 28, at 53, 54 (statement of Thomas J. Miller, Attorney General, State of Iowa).

⁴⁰ The Attorneys General who constituted the State Foreclosure Prevention Working Group tried to collect empirical data but had difficulty extracting loss mitigation data from national banks. *Id.* The published reports can be found online on the Conference of State Bank Supervisors website. *State Foreclosure Prevention Working Group*, CONFERENCE OF STATE BANK SUPERVISORS, <http://www.csbs.org/regulatory/Pages/SFPWG.aspx> (last visited May 12, 2013).

⁴¹ *Foreclosure Crisis Hearing*, *supra* note 29, at 52 (statement of Mark A. Kaufman, Commissioner of Financial Regulation, State of Maryland); *Problems in Mortgage Servicing Hearing*, *supra* note 28, at 126, 135–37 (statement of Diane E. Thompson, National Consumer Law Center). For a particularly egregious account of loan servicer incompetence, see Joe Nocera, *Shamed into Altering a Mortgage*, N.Y. TIMES, Jan. 22, 2011, at B1, available at <http://www.nytimes.com/2011/01/22/business/economy/22nocera.html>.

⁴² Loan servicers pursue loan modification and foreclosure simultaneously in what is called “dual tracking.” When a loan becomes delinquent, the file is sent to both the loss mitigation department to be assessed for a loan modification and to the liquidation department for foreclosure. Communication failures between the departments mean that one hand does not know what the other is doing, causing intense stress and confusion for homeowners. *Foreclosure Crisis Hearing*, *supra* note 29, at 52–53 (statement of Mark A. Kaufman, Commissioner of Financial Regulation, State of Maryland). Both Fannie Mae and Freddie Mac recently put an end to “dual tracking” for delinquent mortgages they own or guarantee so that loan servicers cannot proceed with foreclosure if they are engaged in good faith negotiations for loan modification. Press Release, Fed. Hous. Fin. Authority, Fannie Mae and Freddie Mac to Align Guidelines for Servicing Delinquent Mortgages (Apr. 28, 2011), available at <http://www.fhfa.gov/webfiles/21190/SAI42811Final.pdf>.

⁴³ David Bornstein, *When Lenders Won't Listen*, N.Y. TIMES OPINIONATOR BLOG (Dec. 10, 2010, 10:30 PM), <http://opinionator.blogs.nytimes.com/2010/12/10/when-lenders-wont-listen>.

⁴⁴ *Problems in Mortgage Servicing Hearing*, *supra* note 28, at 126, 135–37 (statement of Diane E. Thompson, National Consumer Law Center).

applications, or one division of the loan servicer continued to pursue foreclosure proceedings while another division was reviewing a modification or the borrower was in the midst of a trial modification period.⁴⁵

In addition to the difficulties in communicating with loan servicers, homeowners with delinquent loans tend not to take the initiative to reach out to their loan servicers to seek assistance. A poll of 2,031 adult homeowners conducted by Freddie Mac in 2005, before the foreclosure crisis, revealed that over half of borrowers in foreclosure proceedings had no contact with their lender or lender's representative before receiving a notice of foreclosure.⁴⁶ Their reasons for not contacting their lender ranged from feeling embarrassed and scared,⁴⁷ to not knowing whom to call, or to being unaware of services their loan servicer could provide, such as talking with a housing counselor, entering into a forbearance agreement, or engaging in loss mitigation.⁴⁸ The poll also found that, in comparison to homeowners in good standing, these delinquent homeowners were generally younger and less affluent as well as less likely to have prior experience with home ownership.⁴⁹ When homeowners did contact their loan servicers, they had no single point of contact at the loan servicer. They spoke to different people at different call centers each time, and as a consequence frequently received misinformation or conflicting recommendations.⁵⁰

⁴⁵ *Id.* at 139–43.

⁴⁶ FREDDIE MAC, FORECLOSURE AVOIDANCE RESEARCH 2 (2005), available at http://www.freddiemac.com/service/msp/pdf/foreclosure_avoidance_dec2005.pdf.

⁴⁷ A Harris Interactive poll asked 1334 homeowners in the United States to describe how they would feel if foreclosure were likely for them. They answered: "scared" (38%), "depressed" (35%), "angry" (9%), "embarrassed" (8%), or "none of these" (9%). NEIGHBORWORKS AM., FORECLOSURE STATISTICS 1 (2007), available at http://www.fdic.gov/about/comein/files/foreclosure_statistics.pdf. A 2007 study conducted by the Neighborhood Housing Services of Chicago asked housing counselors to explain why borrowers fail to contact their loan servicer when they have trouble making payment: "53% responded that most borrowers do not understand that lenders can provide options and 26% suggested that borrowers are too stressed or depressed to take any action. About 10% of counselors wrote that borrowers avoid their lender because they feel mistreated or belittled during interactions with their lender." NEIGHBORHOOD HOUS. SERV. OF CHI., INC., LESSONS FROM THE FRONT LINES: COUNSELOR PERSPECTIVES ON DEFAULT INTERVENTIONS 7 (2007), available at <http://www.nhschicago.org/images/uploads/pages/LessonsFrontLinesOct2007.pdf>.

⁴⁸ Only with some prompting, did homeowners express awareness of other services, such as repayment plans, adding missed payments to the existing loan balance, changing the interest rate, extending the mortgage, switching from an adjustable-rate to a fixed-rate mortgage, or making a lump-sum payment. FREDDIE MAC, *supra* note 46, at 7, 9–10.

⁴⁹ *Id.* at 3.

⁵⁰ See *Problems in Mortgage Servicing Hearing*, *supra* note 28, at 126, 135–37 (statement of Diane E. Thompson, National Consumer Law Center); Nocera, *supra* note 41.

D. *Inadequacy of Conventional Legal Procedure
in the Foreclosure Crisis*

The two primary problems with loan servicer behavior—the preference to foreclose and failures in communication—frequently resulted in unnecessary foreclosures or foreclosures that were not in investors' financial interest. As discussed above, conventional legal procedures presume that a financially motivated lender is making the decision to foreclose, not a third-party loan servicer with its own interests. Unfortunately, it only became evident that conventional legal procedures failed to provide an appropriate check on loan servicer behavior once a record number of homeowners began defaulting in 2008, precipitating a national foreclosure crisis.

1. *Securitization and Loan Servicer Behavior Contributed
to the Crisis*

The national foreclosure crisis unfolded as a result of a confluence of factors, including securitization and loan servicer behavior. The record number of foreclosures that began in 2008 was related to the record number of homeowners with securitized mortgages. The rise in home values in the late 1990s made mortgage-backed securities a profitable investment in high demand. The demand for mortgage-backed securities in turn spurred a proliferation of exotic subprime mortgage products⁵¹ and an industry keen to sell them.⁵² With these

⁵¹ Exotic loan products include hybrid adjustable-rate mortgage loans (ARMs), which enable a borrower to pay the loan at a below-market fixed interest rate for a set period of time, after which the rate continually resets to the market rate for the life of the loan. "Option ARMs" let borrowers choose from different payment options each month—whether a minimum payment, interest-only payment, fully amortizing thirty-year payment, or fully amortizing fifteen-year payment. "Balloon loans" allow borrowers to make low, fixed monthly payments for a short period of time, after which the borrower must pay the remainder in a lump sum. "Interest-only loans" allow borrowers to pay only the accrued interest on their loans for a fixed grace period, after which borrowers begin repaying the principal with significantly higher monthly payments. "Deferred interest loans" or "negative amortization loans" allow borrowers to make monthly payments that are less than what they owe in interest and principal. This often increases, rather than decreases, the size of the loan especially since these loans have payment and interest rate adjustment caps which keep payments the same even if interest rates rise. NAT'L GOVERNORS ASS'N CTR. FOR BEST PRACTICES, ISSUE BRIEF: STATE STRATEGIES TO ADDRESS FORECLOSURES 5 (2007), available at <http://www.nga.org/files/live/sites/NGA/files/pdf/0709FORECLOSURES.PDF>.

⁵² Beginning in the early 2000s, the mortgage market incentivized an "originate-to-distribute" model. Under this model, mortgage brokers originated loans, then sold them to institutions that securitized them, which in turn, sold them to investors on the secondary mortgage market. As a consequence, brokers did not suffer any losses if the borrowers defaulted, reducing their incentive to screen applicants carefully and increasing their incentive to generate new loans. Christopher J. Mayer et al., *The Rise in Mortgage Defaults* 3 (Fed.

subprime mortgage products, people who never before qualified for mortgages could obtain subprime loans to buy a home⁵³ and current homeowners could convert their home equity into cash by refinancing their existing mortgages.⁵⁴ At the time, homeownership was considered an investment that would always yield a return because no one expected housing prices to fall. Homeowners in financial difficulty would not default because they could always sell their home to pay off their loans. Nationwide, homeownership increased from 64.2% in 1994 to a record 69.2% in 2004, an additional twelve million people owning homes.⁵⁵

When the mortgage market began to suffer in 2006 from slowing house price appreciation and a sharp increase in defaults,⁵⁶ largely due to resetting interest rates for subprime ARMs, a record number of homeowners found they could not keep up with payments and defaulted on their loans.⁵⁷ Due in part to the automated practices of the loan servicing industry, loan defaults translated automatically to foreclosure. This first wave of foreclosure filings and subsequent

Reserve Bd., Working Paper No. 2008-59, 2008), available at <http://www.federalreserve.gov/pubs/feds/2008/200859/200859pap.pdf>.

⁵³ "Subprime" or "near-prime" mortgages are generally targeted to borrowers who have problematic credit history, minimal savings, and/or an inability or unwillingness to document assets or income. The number of newly originated sub-prime mortgages almost doubled between 2003 and 2005, jumping from 1.1 million to 1.9 million. *Id.* at 3-4 (detailing the attributes of subprime, near-prime, and prime mortgage products, and explaining why delinquency and default rose so sharply through 2008). The vast majority of subprime loans were targeted at racial minorities, even though some of these homeowners qualified for less expensive loans. Winnie F. Taylor, *Eliminating Racial Discrimination in the Subprime Mortgage Market: Proposals for Fair Lending Reform*, 18 J.L. & POL'Y 263 (2009).

⁵⁴ JOSH ROSNER, GRAHAM FISHER & CO., HOUSING IN THE NEW MILLENNIUM: A HOME WITHOUT EQUITY IS JUST A RENTAL WITH DEBT 19-21 (2001), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1162456 (predicting that, as rising real estate values increased the equity value of the home, more and more American consumers would draw down their home-equity in order to maintain a particular lifestyle). For detailed reporting on the interface between the housing industry and the subprime mortgage industry in Florida leading up to the foreclosure crisis, see George Packer, *The Ponzi State*, NEW YORKER, Feb. 9, 2009, at 81.

⁵⁵ MARK DOMS & MERYL MOTIKA, FED. RESERVE BANK OF S.F., NO. 2006-30, FRBSF ECONOMIC LETTER: THE RISE IN HOMEOWNERSHIP (2006), available at <http://www.frbsf.org/publications/economics/letter/2006/el2006-30.html>; *Historical Census of Housing Tables*, UNITED STATES CENSUS BUREAU, <http://www.census.gov/hhes/www/housing/census/historic/owner.html> (last updated Oct. 31, 2011).

⁵⁶ Between 1979 and 2006, the share of mortgage loans that were "seriously delinquent," or ninety days or more past due or in the process of foreclosure, averaged 1.7%. By the second quarter of 2008, the share jumped to 4.5%. Mayer et al., *supra* note 52, at 2 (citing data from the Mortgage Bankers Association).

⁵⁷ The share of seriously delinquent subprime residential mortgages increased from 5.6% in mid-2005 to over 21% in 2008. Mayer et al., *supra* note 52, at 3. In 2007, approximately 852,000 foreclosures were opened for subprime mortgages and approximately 553,000 foreclosures were opened for prime mortgages, totaling approximately 1,558,000 foreclosures. Cordell et al., *supra* note 12, at 7 (using data from the Mortgage Bankers Association National Delinquency Survey to estimate inventory of subprime and prime mortgages from 2004-2007 and the first two quarters of 2008).

foreclosure sales flooded the housing market and caused property values to spiral downward. Many homes were now worth less than the loans and investments they secured.⁵⁸ By 2008, the investment losses created by these foreclosures and the sinking housing market resulted in the collapse of a number of financial institutions and launched a Great Recession.⁵⁹ With recession came unemployment and a second wave of foreclosures for homeowners unable to afford mortgage payments and unable to sell in a market already saturated with homes.⁶⁰

The quantity of foreclosures and consequent financial losses are staggering. The numbers of residential mortgage loans entering foreclosure jumped from 800,000 in 2005,⁶¹ when housing prices were still rising, to 2.8 million in 2009 and 2.9 million in 2010. Of the nearly eight million homes that entered foreclosure since mid-2007, loan servicers repossessed over three million.⁶² The total losses to individual families that have been foreclosed upon are projected to exceed \$2.6

⁵⁸ When the value of a home is less than the value of the mortgage, meaning that selling the home at market value cannot pay off the loan, the property has no equity and is considered "underwater." In 2011, sixty percent of all homes in Nevada were underwater and the percentages of homes underwater in Arizona and Florida were forty-eight percent and forty-five percent, respectively. WALSH, *supra* note 38, at 33 (citing CoreLogic data on negative equity from September 13, 2011). For many homeowners whose houses are underwater, the property is also "overleveraged," meaning that the homeowners owe so much on the mortgage that they are unable to pay the interest payments for the loan. The first wave of foreclosures occurred because homeowners were overleveraged and could not keep up with the ARM payments when interest rates reset. The drop in the housing market caused many more homes to be underwater because the amount owed on the loan exceeded the market value of the home.

⁵⁹ To help banks survive the Great Recession, the federal government disbursed \$475 billion in bailouts under the Dodd-Frank Wall Street Reform and Consumer Protection Act, a figure lower than the \$700 billion originally envisioned by the Troubled Asset Relief Program (TARP). See Dodd-Frank Wall Street Reform and Consumer Protection (Dodd-Frank) Act of 2010, Pub. L. No. 111-203, § 1302, 124 Stat. 1376, 2133 (amending 12 U.S.C. § 5225(a) (2006)).

⁶⁰ GETTER ET AL., *supra* note 7, at 11.

⁶¹ *Problems in Mortgage Servicing Hearing*, *supra* note 28, at 352, 353 (statement of Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation) (citing an FDIC estimate based on data from the Mortgage Bankers Association data and the American Housing Survey). According to RealtyTrac estimates, in 2010, 2.23% of all U.S. housing units received at least one foreclosure filing, up from 2.21% in 2009, 1.84% in 2008, 1.03% in 2007 and 0.58% in 2006. *Record 2.9 Million U.S. Properties Receive Foreclosure Filings in 2010 Despite 30-Month Low in December*, REALTYTRAC (Jan. 12, 2011), <http://www.realtytrac.com/content/press-releases/record-29-million-us-properties-receive-foreclosure-filings-in-2010-despite-30-month-low-in-december-6309>.

⁶² *Problems in Mortgage Servicing Hearing*, *supra* note 28, at 102, 102 (statement of Adam J. Levitin, Associate Professor of Law, Georgetown University Law Center) (citing HOPE Now Data Reports). The National Fair Housing Alliance studied how financial institutions care for properties on which they have foreclosed. The study found that real estate owned properties in African-American or Latino neighborhoods were not as well-maintained or marketed for sale, as in areas with a large White population, making it harder for minority neighborhoods to recover. NAT'L FAIR HOUS. ALLIANCE, *HERE COMES THE BANK, THERE GOES OUR NEIGHBORHOOD: HOW LENDERS DISCRIMINATE IN THE TREATMENT OF FORECLOSED HOMES* (2011), available at <http://www.nationalfairhousing.org/Portals/33/There%20Goes%20Our%20Neighborhood%20-%20REO%20report.pdf>.

trillion with additional trillions in losses to neighborhoods and communities.⁶³ Foreclosures have not only harmed homeowners and communities, but also those who invested in mortgage backed securities.⁶⁴

2. Legal Procedures Failed to Protect Homeowners and Investors

Existing foreclosure processes in all states were simply not equipped to handle the record numbers of foreclosures, the collapsed housing market, and the triangulated relationship between borrowers, loan servicers, and investors. Securitization changed how foreclosure decisions were made. As a result, a basic presumption of conventional foreclosure laws no longer applied and instead millions of foreclosures occurred without a cost-benefit analysis to determine the best option for recouping the value of the loan. Borrowers and investors suffered the consequences and local and national economies suffered.

The sheer volume of foreclosures was overwhelming and compromised the integrity of foreclosure proceedings. For example, Florida's state courts were flooded with cases: during the month of April, 2009, one in every 135 housing units received a foreclosure filing notice.⁶⁵ In Florida's Twentieth Judicial Circuit, the court created a

⁶³ *Problems in Mortgage Servicing Hearing*, *supra* note 28, at 126, 130 (statement of Diane E. Thompson, National Consumer Law Center) (citing STAFF OF THE J. ECON. COMM., 110th Cong., 2d Sess., STATE BY STATE FIGURES: FORECLOSURE AND HOUSING WEALTH LOSSES (2008)). Communities suffer from foreclosure because vacant, foreclosed properties lower the value of neighboring properties. Local governments lose tax revenue and also have increased costs associated with unpaid sewer and water bills and handling building code violations from unmaintained properties. See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-34, VACANT PROPERTIES: GROWING NUMBER INCREASES COMMUNITIES' COSTS AND CHALLENGES 27-48 (2011), available at <http://www.gao.gov/assets/590/586089.pdf>.

⁶⁴ Foreclosing on a home with a loan balance at the national median in 2008 resulted in around an average loss to investors of \$145,000 per home foreclosure. See WALSH, *supra* note 38, at 33 (citing Alan M. White, *Deleveraging the American Homeowner: The Failure of the 2008 Voluntary Mortgage Contract Modifications*, 41 CONN. L. REV. 1107 (2009)). All types of investors have interests in mortgage-backed securities, from the big banks to pension funds to private endowments. See Robert Lenzer, *Lessons Learned a Year After Lehman's Demise*, FORBES (Aug. 21, 2009), <http://www.forbes.com/2009/08/21/bernanke-bailout-paulson-personal-finance-investing-ideas-lehman-brothers.html>.

⁶⁵ Florida, a judicial foreclosure state, was one of the states hit earliest and hardest by the foreclosure crisis. In April 2009, three of the ten metropolitan areas in the United States with the highest foreclosure rates were in Florida. JAKABOVICS & COHEN, *supra* note 9, at 22 (citing *Foreclosure Activity Remains at Record Levels in April*, REALTYTRAC (May 12, 2009), <http://www.realtytrac.com/content/press-releases/foreclosure-activity-remains-at-record-levels-in-april-4883>). The percent increases in foreclosure filings in Florida's judicial circuits between 2006-2008 is astounding: 230% (First Circuit), 444% (Ninth Circuit), 474% (Eleventh Circuit), 631% (Twelfth Circuit), 496% (Fifteenth Circuit), 387% (Eighteenth Circuit), 550% (Nineteenth Circuit), and a whopping 788% (Twentieth Circuit). *Id.* at 24-25.

"rocket docket"⁶⁶ and called judges out of retirement to assist with a docket deluged by more than 1000 cases per day.⁶⁷ Most hearings lasted for less than one minute because judges asked homeowners only two questions: "Are you current on your mortgage?" and "Are you living in your home?" If the answers were "no" and "yes," then homeowners were given sixty days to vacate the premises.⁶⁸ Little to no time was spent by the judge assessing the merits of the foreclosure petition, such as whether the entity seeking foreclosure had the legal right to do so and whether it had complied with state law.⁶⁹

The conventional foreclosure process does not require a cost-benefit analysis of whether the securitized loan is performing in accordance with the investors' financial interest. It lacks this assessment step because it dates to a primary mortgage market era when a lender and borrower had the ability to interact closely. Borrowers and investors in a secondary mortgage market lack this close relationship and therefore cannot respond to market changes that negatively impact the value of the collateral and that were not anticipated at the time the mortgage originated. For example, loan servicers continued to foreclose even after the flood of homes on the market decreased the value of homes markedly and eviscerated the value of investors' interests.

Although conventional foreclosure proceedings failed to protect borrowers or investors, it proved difficult for states to find a solution to the problem. Securitization made foreclosure a national economic activity difficult for individual states to regulate. There was no blanket legislation that could be passed to end foreclosures entirely and reset mortgages to reflect market realities. Foreclosure is a contractual remedy for lenders when a loan is delinquent and, although state governments could delay foreclosure,⁷⁰ they could not deny lenders the right to foreclose.⁷¹ Furthermore, the financial situation of each

⁶⁶ JAKABOVICS & COHEN, *supra* note 9, at 22.

⁶⁷ Michael Corkery, *A Florida Court's "Rocket Docket" Blasts Through Foreclosure Cases*, WALL ST. J., Feb. 18, 2009, at A1, available at <http://online.wsj.com/article/SB123491755140004565.html>. There are accounts of loan servicer lawyers using hand trucks to exchange boxes of legal documents from the morning cases with the boxes of afternoon cases. See JAKABOVICS & COHEN, *supra* note 9, at 22.

⁶⁸ Corkery, *supra* note 67.

⁶⁹ The robo-signing scandal is a prime example of how foreclosure procedures broke down during the foreclosure crisis. See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-433, MORTGAGE FORECLOSURES: DOCUMENTATION PROBLEMS REVEAL NEED FOR ONGOING REGULATORY OVERSIGHT 1, 11-12 (2011), available at <http://www.gao.gov/assets/320/317923.pdf>.

⁷⁰ Many states passed moratoria on foreclosure after the robo-signing scandal was uncovered. Bank of America also put a moratorium on housing foreclosures in all fifty states so that it could investigate the documents being used to justify homeowner evictions.

⁷¹ At the very least, the Contracts Clause and the Takings Clause of the U.S. Constitution restrict the extent to which federal and state governments can enact laws controlling mortgage foreclosures. See Geoff Walsh, *The Finger in the Dike: State and Local Laws Combat the*

homeowner and the reasons for being in default were highly individualized, making it extremely difficult for a legislature to develop a law tailored narrowly enough to achieve its compelling interest to protect homeowners by the least restrictive means possible. Thus, state and local governments focused on ways to restructure foreclosure procedures for homeowners who were either struggling with making mortgage payments or were already delinquent. One way in which governments restructured foreclosure procedure was to include ADR as a step in the foreclosure process.

II. AN ADR RESPONSE TO CRISIS

The use of ADR can restore integrity to foreclosure procedures by ensuring that only necessary foreclosures take place, ultimately averting further crisis and stabilizing the economy. Incorporating an ADR-based negotiation step in conventional foreclosure proceedings counteracts the automated practices of the loan servicing industry by making the loan servicer consider the value of the loan based on the local housing market and the borrower's ability to make future payments. Through a structured negotiation process, the borrower and loan servicer together create a solution that considers new market realities and provides a plan of action that satisfies the needs of homeowners and investors.

State and local governments established foreclosure ADR programs with clear objectives that directly respond to the problems associated with securitized loan servicing that contributed to the foreclosure crisis.⁷² To further these objectives, programs target homeowners with delinquent loans and give them an opportunity to sit down with the loan servicers⁷³ and negotiate alternatives to foreclosure.

Foreclosure Tide, 44 SUFFOLK U. L. REV. 139 (2011) (providing a historical survey of the constitutionality of state moratoria on foreclosure as well as an analysis the constitutionality of state foreclosure mediation programs).

⁷² Using ADR as a way for parties in conflict to develop solutions tailored to their interests is not a novel concept; however, these programs are unique in that they are being employed as a public policy initiative to respond where existing laws have proven inadequate. Courts have encouraged ADR to help manage crowded dockets and also to make it possible for parties to settle disputes themselves, rather than by relying on a judge. It is increasingly common for parties to elect to use an ADR process to resolve conflicts privately, rather than going to court. However, parties usually turn to an ADR process because the default, going to court, is public, more expensive, and time intensive, not because the default lacks integrity, which is what happened to foreclosure proceedings during the foreclosure crisis.

⁷³ For these programs, "lender" and "loan servicer" are interchangeable. Where program rules or statutory language refer to the obligations of a lender entity, it is understood that, for securitized loans, it is the loan servicer who will be required to comply.

A. Foreclosure ADR Program Objectives

There are five primary objectives of foreclosure ADR programs that attempt to respond to the problems associated with securitized loan servicing and the foreclosure crisis. They are to 1) resolve communication barriers caused by securitization, 2) provide oversight of loan servicers' conduct, 3) educate homeowners about their rights in foreclosure, 4) assist with a high volume of cases in court, and 5) alleviate community blight. Frequently, a particular ADR program works to further several of these objectives simultaneously.

In order to overcome communication barriers, a fundamental problem at the heart of the foreclosure crisis, foreclosure ADR programs physically bring borrowers and loan servicers together for a conversation about the loan. Some programs assemble parties and expressly instruct them to talk about the possibility of modifying or restructuring of the loan so that unnecessary foreclosures do not occur.⁷⁴ Where loss-mitigation is not an option, the parties are directed to explore non-retention plans that allow the lender to take title of the property without having to foreclose. Connecticut's foreclosure mediation program, the first, state-wide program in the country,⁷⁵ provides a good illustration. Of primary concern to the Connecticut legislature was the fact that individuals and communities would suffer⁷⁶ because many homeowners were failing to take the initiative to reach out to lenders and engage in negotiations around a loan modification or alternative to foreclosure.⁷⁷ Connecticut's mediation program empowers

⁷⁴ See, e.g., MD. CODE ANN., REAL PROP. § 7-105.1(l)(3) (West 2012) (“[P]arties and the mediator shall address loss mitigation programs that may be applicable to the loan secured by the mortgage or deed of trust that is the subject of the foreclosure action.”); NEV. FORECLOSURE MEDIATION R. 1.1. The general purpose of Nevada’s foreclosure mediation program is to “[encourage] deed of trust beneficiaries (lenders) and homeowners (borrowers) to exchange information and proposals that may avoid foreclosure.” *Id.* 1.2.

⁷⁵ A Connecticut law entitled, “An Act Concerning Responsible Lending and Economic Security,” was a large consumer protection bill that, in addition to creating a foreclosure mediation program, gave the Connecticut Banking Department the regulatory tools to more closely supervise mortgage lenders and crack down on predatory lending as well as an Emergency Mortgage Assistance Program. 2008 Conn. Acts, Public Act No. 08-176 (Reg. Sess.).

⁷⁶ The comments of Representative Barry (Twelfth District), Chair of the Banks Committee, convey the real fears, shared by many people around the country, that the foreclosure crisis would bring poverty, homelessness, blight, and further economic damage. CONN. GEN. ASSEMB., TRANSCRIPT OF HOUSE DEBATE ON H.R. 5577 (May 5, 2008) [hereinafter CONN. HOUSE DEBATE OF H.R. 5577], available at <http://search.cga.state.ct.us/dtsearch.asp?cmd=getdoc&DocId=23039&Index=I%3A\zindex\2008&HitCount=0&hits=&hc=0&req=&Item=2791>.

⁷⁷ Representative Barry stated during the debate:

No amount of marketing is going to get a borrower . . . to reach out to the lender to discuss their [sic] options. The mediation program will serve the purpose of identifying people who can be helped and directing them to the right resources to keep them in their home.

the state and the judiciary to direct homeowners and borrowers to have a structured conversation, presided over by a neutral mediator, about whether there are any alternatives to proceeding with a foreclosure.⁷⁸ The legislature outlined the topics to be addressed during mediation: "all issues of foreclosure, including, but not limited to, reinstatement of the mortgage, assignment of law days, assignment of sale date, restructuring of the mortgage debt and foreclosure by decree of sale."⁷⁹

In creating foreclosure ADR programs, state and local governments also tried to create a mechanism to oversee loan servicers' compliance with federal loan modification programs⁸⁰ and to ensure that loan servicers indeed have the legal right to foreclose on the property. Federal loan modification standards are established by the Home Affordable Modification Program (HAMP);⁸¹ many state and local programs fold HAMP analysis into the ADR process. HAMP creates incentives⁸² for loan servicers to restructure home mortgages for

....

But I think this is the best way to put people who are in foreclosure, who have been given foreclosure notices. They oftentimes don't respond to their mail. They have a pride issue, maybe sometimes their dignity doesn't allow them to respond to a complaint in the mail and the clock's ticking.

CONN. HOUSE DEBATE OF H.R. 5577, *supra* note 76 (statement of Representative Ryan P. Barry, 12th District).

⁷⁸ See *id.*

⁷⁹ CONN. GEN. STAT. § 49-31m. (2013).

⁸⁰ Many loan servicers failed to comply with HAMP requirements. Homeowners around the country reported difficulty in working with their loan servicers because information was inconsistent and confusing, loan servicers lost documents or made repeated requests for documents already submitted, and improperly calculated borrowers' income or misapplied HAMP guidelines. U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-367R, TROUBLED ASSET RELIEF PROGRAM: RESULTS OF HOUSING COUNSELORS SURVEY ON BORROWERS' EXPERIENCES WITH THE HOME AFFORDABLE MODIFICATION PROGRAM 5-6, 8 (2011). Homeowners often waited four to six months for a decision from a loan servicer about a HAMP application. *Id.* at 6. During this waiting period, penalties and late fees on a delinquent loan accrued and made it harder to cure. Where a trial modification was granted, many homeowners were still denied permanent modifications even after successfully completing the trial modification period. *Id.* at 8.

⁸¹ As part of the federal response to the foreclosure crisis, President Obama rolled out a "Homeowner Affordability and Stability Plan." The plan has three parts: refinancing, loan modification, and strengthening of Fannie Mae and Freddie Mac. A primary component of the plan, the Making Home Affordable Program, which took effect in late February, 2009, focused on helping homeowners at risk of foreclosure secure refinancing or modification of loans through either the Home Affordable Refinance Program (HARP) or the Home Affordable Modification Program (HAMP). See *Obama Administration's Home Mortgage Crisis Fact Sheet*, WASH. POST (Feb. 18, 2009), <http://www.washingtonpost.com/wp-dyn/content/article/2009/02/18/AR2009021801159.html>. Both HAMP and HARP give incentives for loan servicers to either modify or refinance mortgages for people whose homes have lost value. See FANNIE MAE, HOME AFFORDABLE REFINANCE (DU REFI PLUS AND REFI PLUS) FAQs (2013), <https://www.efanniemae.com/sf/mha/mharefi/pdf/refinancefaqs.pdf>; *Home Affordable Refinance Program (HARP)*, MAKING HOME AFFORDABLE PROGRAM, <http://www.makinghomeaffordable.gov/programs/lower-rates/Pages/harp.aspx> (last updated Apr. 12, 2013).

⁸² MAKING HOME AFFORDABLE PROGRAM, HANDBOOK FOR SERVICERS OF NON-GSE

eligible⁸³ homeowners who are behind with payments or on their way default. The intended effect of restructuring these loans is for homeowners to stay in their homes with lower, sustainable monthly mortgage payments.⁸⁴ Under HAMP, participating loan servicers⁸⁵ must modify the loan so that a homeowner's monthly payments are no greater than thirty-one percent of her gross monthly income.⁸⁶ HAMP also demands that participating loan servicers establish a single point of contact for borrowers so that they can communicate with the same individual about the particulars of their case, reducing the confusion of mixed messages.⁸⁷ To ensure homeowners are considered for HAMP, some foreclosure ADR give the parties explicit instructions for HAMP analysis. For example, one program requires lenders to conduct a net-present-value calculation as a precursor to mediation so that the parties enter the mediation ready to discuss the homeowners' eligibility for modification.⁸⁸ Many programs established after the robo-signing scandal and loan servicer misconduct came to light, provide even more oversight of loan servicers because they introduce additional instructions, such as requiring loan servicers to confirm that the

MORTGAGES (2011), available at https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/mhahandbook_34.pdf. For example, Supplemental Directive 11-06 increased the dollar amount loan servicers are eligible to receive for permanently modifying loans and created a sliding scale so that servicers receive more money if they provide a permanent modification for loans that are less than 120 days delinquent. See MAKING HOME AFFORDABLE PROGRAM, SUPPLEMENTAL DIRECTIVE 11-06: MAKING HOME AFFORDABLE PROGRAM—UPDATES TO SERVICES INCENTIVES 1 (2011), https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/sd1106.pdf.

⁸³ Homeowners eligible for a loan modification under HAMP must occupy the property as a primary residence, owe up to \$729,750 on the current mortgage, and have a first mortgage issued before January 1, 2009 with a monthly payment greater than thirty-one percent of the gross monthly household income. See *Home Affordable Modification Program*, MAKING HOME AFFORDABLE PROGRAM, <http://www.makinghomeaffordable.gov/programs/lower-payments/Pages/hamp.aspx> (last updated Mar. 21, 2013).

⁸⁴ Borrowers who are eligible for HAMP must complete a ninety-day trial modification period before the modification becomes permanent. See U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-367R, TROUBLED ASSET RELIEF PROGRAM: RESULTS OF HOUSING COUNSELORS SURVEY ON BORROWERS' EXPERIENCES WITH THE HOME AFFORDABLE MODIFICATION PROGRAM 3 (2011), available at <http://www.gao.gov/assets/100/97516.pdf>.

⁸⁵ All loan servicers that received TARP (Troubled Asset Relief Program) funds must participate in HAMP. Federal GSEs like Fannie Mae and Freddie Mac also participate in HAMP.

⁸⁶ MAKING HOME AFFORDABLE PROGRAM, *supra* note 82, at 176.

⁸⁷ See David Streitfeld, *Servicers Said to Agree to Revamped Foreclosures*, N.Y. TIMES, Apr. 6, 2011, at B4.

⁸⁸ For example, Vermont's foreclosure mediation statute requires lenders to calculate net present value in accordance with HAMP guidelines and to produce, for the homeowner and the mediator, the net present value inputs and outputs. VT. STAT. ANN. tit. 12, § 4633 (2010). Vermont's statute anticipated what the Dodd-Frank Act would also require, which is that the U.S. Treasury make available a web-based net-present-value calculator that the public could use to determine the value of a home and whether the mortgage would qualify for a loan modification under HAMP. Dodd-Frank Act of 2010, Pub. L. No. 111-203, § 1482, 124 Stat. 1376, 2203 (codified at 12 U.S.C. § 5219a (2012)).

foreclosing party has possession of the note and therefore the legal right to foreclose, as part of a comprehensive oversight machinery.⁸⁹

State and local governments also rely on foreclosure ADR programs to educate homeowners about the foreclosure and loan modification process. As discussed earlier, many delinquent homeowners are generally younger, less affluent, and less likely to have prior experience with home ownership than homeowners whose loans are in good standing.⁹⁰ Furthermore, communicating with loan servicers can be problematic, paperwork is lost and telephone calls are not returned, the instructions for applying for a modification can be diffuse, and the modification review process is often opaque. Almost all foreclosure dispute resolution programs integrate housing counseling approved by the U.S. Department of Housing and Urban Development (HUD)⁹¹ as a free service for borrowers delinquent on their loans and facing foreclosure.⁹² Housing counselors educate homeowners about their rights in foreclosure, explain the foreclosure process, and help them communicate with their loan servicer about foreclosure alternatives.

A fourth program goal of state and local governments utilizing foreclosure ADR programs is to encourage cases to settle when appropriate. This goal is especially important to judicial foreclosure jurisdictions that require foreclosure actions to go through the courts. Programs in these jurisdictions bring parties to the negotiation table to discuss whether foreclosure is the only option available. Court dockets

⁸⁹ See discussion on required document exchange *infra* Part II.F.

⁹⁰ See *supra* text accompanying note 49.

⁹¹ HUD has had a Housing Counseling Assistance Program since the 1970s. Housing counseling organizations are approved by HUD to educate millions of people on a variety of housing related issues, from educating potential buyers about homeownership and mortgages, to foreclosure prevention, budgeting, maintenance of mortgage payments post-purchase, and counseling about reverse mortgages, rental, and homelessness. The number of homeowners seeking assistance with foreclosure from housing counselors jumped by thirty-six percent from 2006–2009. For a full description of the Program and its involvement in responding to the foreclosure crisis, see *HUD and NeighborWorks Housing Counseling Oversight: Hearing Before the Subcomm. on Ins., Hous. and Cmty. Opportunity of the H. Comm. on Fin. Servs.*, 112th Cong. 89 (2011) (statement of Deborah C. Holston, Deputy Assistant Secretary for Single Family Housing, U.S. Department of Housing and Urban Development). Congress recently recognized the importance of housing counseling in allaying the foreclosure crisis by calling for the creation of an Office of Housing Counseling as part of the Dodd-Frank Act. See Dodd-Frank Act of 2010, Pub. L. No. 111-203, § 1442, 124 Stat. 1376, 2163–65 (amending 42 U.S.C. § 3533 (2006)).

⁹² WALSH, *supra* note 38, at 5. Washington, for example, created its statewide foreclosure mediation program in order to “encourage homeowners to utilize the skills and professional judgment of housing counselors as early as possible in the foreclosure process” and “[p]rovide a process for foreclosure mediation when a housing counselor or attorney determines that mediation is appropriate.” 2011 Wash. Sess. Laws 580.

are thus cleared of cases that can settle, thereby improving the efficiency and timeliness of *necessary* foreclosures.⁹³

Finally, state and local governments rely on foreclosure ADR programs to fulfill the most essential of these objectives: stabilizing local communities weakened by the foreclosure crisis. For example, the municipal foreclosure mediation program in Providence, Rhode Island provides a sweeping statement of policy. Citing the negative impact of residential mortgage foreclosure actions that “give impetus to the continuation, extension and aggravation of urban blight and decay,”⁹⁴ the city ordinance explains that the purpose of the foreclosure mediation program is:

[T]o protect the public health, safety and welfare by providing (a) early, HUD-approved independent counseling agency-supervised intervention in residential owner-occupied mortgage foreclosure cases which will assure timely determination of eligibility under various federal, state and local programs established to facilitate loan work-out and other solutions to permit residential homeowners, where possible, to retain their properties and permit lenders to move forward to recordation of a deed and subsequent auction/sale of the properties upon conclusion of the process.⁹⁵

⁹³ For example, Ohio's model foreclosure mediation program is designed to “assist courts in managing the explosion of foreclosure cases on their dockets for a more efficient administration of justice while assisting Ohio's most vulnerable homeowners facing the prospect of losing their homes.” *Foreclosure Mediation Program Now Available to Ohio Courts*, THE SUPREME COURT OF OHIO (Feb. 7, 2008), http://www.supremecourtsohio.gov/PIO/news/2008/foreclosure_020708.asp; see also *In re a Foreclosure Mediation ADR Option—Administrative Order No. 2009-00001* § 1, No. D-0101-CV-77-52749 (N.M. Dist. Ct. 1st Apr. 30, 2009) [hereinafter N.M. Admin. Order No. 2009-00001], available at http://www.nclc.org/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/nm_admin_order.pdf (stating that the Foreclosure Mediation Pilot program is intended “to minimize case processing time, save costs and expense for the parties, and assist the parties in resolving the issues by working out new mortgage terms where possible or other agreements mutually acceptable to both parties”).

⁹⁴ PROVIDENCE, R.I., CODE OF ORDINANCES § 13-214 (2011). The full policy statement is compelling and illustrates the real sense of crisis gripping the community:

It is hereby declared that residential mortgage foreclosure actions, caused in part by so called sub-prime mortgage lending and predatory lending practices as well as rising interest rates, unemployment and underemployment, have negatively impacted a substantial number of homeowners in the city, creating a foreclosure crisis which endangers the economic stability of the city and the health and safety of its citizens, as the increasing numbers of foreclosures lead to increases in unoccupied and unattended buildings in the city and give impetus to the continuation, extension and aggravation of urban blight and decay. More importantly, foreclosures cause the unnecessary and unwanted displacement of a considerable number of homeowners and tenants who desire to live and work in the city.

Id.

⁹⁵ *Id.* § 13-215.

B. *Vital Characteristics Furthering ADR Program Objectives*

In order to accomplish the aforementioned objectives, state and local foreclosure ADR programs requiring borrowers and loan servicers to negotiate a looming foreclosure action share two essential characteristics. First, to be eligible for these programs borrowers must be owner-occupiers of the property in jeopardy and that property must be the borrower's primary residence.⁹⁶ Second, the programs require direct communication about the loan between the borrower and the lender or loan servicer. In general, a representative of the lender, usually an attorney hired by the loan servicer, must appear in person and must have the authority to negotiate and modify the loan secured by the mortgage.⁹⁷ Some programs allow the lender to engage in the foreclosure negotiation by phone.⁹⁸

Limiting these programs to borrowers who are owner-occupiers facing foreclosure allows state and local governments to reach the demographic most negatively affected by the foreclosure crisis. The number of residential foreclosures has been unprecedented. The loss of homeowners due to residential foreclosure and subsequent depletion of communities continues to pose the greatest threat to economic stability in the United States.⁹⁹ By targeting homeowners who are actively living in their homes under threat of foreclosure, jurisdictions further their objectives of clearing court dockets, educating borrowers, and stabilizing communities.

Additionally, the requirement that a representative of the lender appear in person at the negotiation is a crucial component to helping programs achieve the other two objectives, overcoming barriers to communication and monitoring loan servicer conduct. The secondary mortgage market, with its array of anonymous investors, makes it impossible for a homeowner to negotiate with the entity or entities that have a secured interest in the borrower's home. Compelling a single individual, with a name, phone number, email address, and the authority to negotiate the terms of the loan, to materialize and assess

⁹⁶ E.g., CONN. GEN. STAT. § 49-31k (2011); NEV. REV. STAT. § 107.086(12)(c) (2011); Residential Mortgage Foreclosure Mediation Program, Administrative Directive No. 2011-2 (Del. Super. Ct. Jan. 20, 2011) [hereinafter *Del. Admin. Directive 2011-2*], available at http://courts.delaware.gov/Superior/pdf/Administrative_Directive_2011_2.pdf. By contrast, Florida's program, which allowed owners of non-residential property to request mediation. Revision of Mortgage Foreclosure Procedures, Administrative Order No. 2012-002 PA/PI-CIR, (Fla. Cir. Ct. 6th Jan. 20, 2012), available at <http://www.jud6.org/legalcommunity/LegalPractice/AOSAndRules/aos/aos2012/2012-002.htm>.

⁹⁷ See, e.g., NEV. FORECLOSURE MEDIATION R. 10(1)(a); see also MD. CODE ANN., REAL PROP. § 7-105.1(a)(3) (West 2012).

⁹⁸ Nevada's program allows lenders to participate by phone only if they can show good cause. NEV. FORECLOSURE MEDIATION R. 10(1)(a).

⁹⁹ FED. RESERVE SYS., *supra* note 3.

foreclosure alternatives is perhaps the most powerful and effective tool that these programs provide to homeowners.

III. FORECLOSURE ADR PROGRAM BEST PRACTICES

State and local governments have important decisions to make about how to create, structure, and implement foreclosure ADR programs so that they reach their primary objectives. When making these decisions, it is useful to compare key components of existing foreclosure ADR programs and identify best practices. By relying on best practices, state and local governments are more likely to avoid unnecessary foreclosures and have a maximum impact on allaying the foreclosure crisis. In creating, structuring, and implementing foreclosure ADR programs, state and local governments must consider key program components ranging from how a program is created to when the negotiation opportunity is introduced in the foreclosure timeline and how homeowners become enrolled. They must also consider who presides over the negotiations, whether they include housing counseling and legal services, what information the program requires from homeowners and loan servicers, whether there are sanctions and judicial oversight, and how the program is funded.

In examining key components of existing foreclosure ADR programs, a number of themes emerge to guide governments crafting programs while trying to account for local realities. For example, state and local governments must ensure both efficiency of process and a meaningful opportunity for informed negotiation between the parties. They also have to balance the scale of the program with the resources available to administer it. Finally, the difference in sophistication between homeowners and loan servicers can create a power imbalance between the parties and raises concerns about how to best protect homeowners in an ADR process.¹⁰⁰

¹⁰⁰ Scholars have written extensively on the dangers of "power imbalance" between parties in litigation, mediation, and other ADR processes. See, e.g., Marc Galanter, *Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change*, 9 L. & SOC'Y REV. 95 (1974); Carrie Menkel-Meadow, *Whose Dispute Is It Anyway?: A Philosophical and Democratic Defense of Settlement (In Some Cases)*, 83 GEO. L.J. 2663 (1995); Laura Nader, *Controlling Processes in the Practice of Law: Hierarchy and Pacification in the Movement to Re-Form Dispute Ideology*, 9 OHIO ST. J. ON DISP. RESOL. 1 (1993); Laura Nader, *Disputing Without the Force of Law*, 88 YALE L.J. 998 (1979); Jean R. Sternlight, *ADR Is Here: Preliminary Reflections on Where It Fits in a System of Justice*, 3 NEV. L.J. 289 (2003); Jean R. Sternlight, *Is Alternative Dispute Resolution Consistent with the Rule of Law? Lessons from Abroad*, 56 DEPAUL L. REV. 569 (2007). There has been some attention to the use of ADR in foreclosure proceedings, but the focus has been on whether mediation, in its most essential form, can protect borrowers. See Shana H. Khader, *Mediating Mediations: Protecting the Homeowner's Right to Self-Determination in Foreclosure Mediation Programs*, 44 COLUM. J.L. & SOC. PROBS. 109 (2010). A question for further examination is whether fundamental principles of mediation align with

A. *Program Creation and Implementation*

State and local governments can choose to create foreclosure ADR programs by state statute, local ordinance, or judicial rule.¹⁰¹ Whether the program was created by the state legislature, local government, or courts is a function of factors such as the political will in the state,¹⁰² the authority of the municipal governments, and the statutory power granted to the judiciary.¹⁰³ Nevertheless, there are some clear advantages to creating a foreclosure ADR process through legislative action, rather than judicial rule, in both judicial and nonjudicial foreclosure states.

Judiciaries have the authority to create foreclosure ADR programs by passing rules that regulate how foreclosure cases proceed through the courts. Establishing a program by judicial rule may be more expedient than the political process. However, when it comes to implementing a foreclosure ADR program, judiciaries face limitations. First, the program will apply exclusively to judicial foreclosure; eliminating homeowners facing nonjudicial foreclosure may be a problem for states that allow both forms of foreclosure. Second, the application of judicial rules is usually left to decentralized local courts so there may be program inconsistencies within the state. Given these realities, many state judiciaries have created a model framework of best practices for each local court to adopt. Compare, for example, the different experiences of the foreclosure mediation programs created by state judiciaries in Ohio¹⁰⁴ and Florida,¹⁰⁵ both of which created a model

those of consumer protection.

¹⁰¹ Two programs were created through a partnership between a local law school and either the judiciary or the Attorney General. In Milwaukee, Wisconsin, a judicial foreclosure state, Chief Justice Jeffrey A. Kremers signed directive 09-14 to start a foreclosure mediation program run and coordinated by the Marquette Law School. Foreclosure Procedures, Chief Judge Directive 09-14 (Wis. Dist. Ct. 1st July 10, 2009). In Arizona, a non-judicial foreclosure state, the Arizona State University Sandra Day O'Connor School of Law established a mediation program for non-judicial foreclosures that are part of bankruptcy proceedings. *See Foreclosure Mediation Unit*, Sandra Day O'Connor Sch. of Law, <http://www.law.asu.edu/programs/Programs/LodestarDisputeResolutionProgram/ForeclosureMediationUnit.aspx> (last visited May 16, 2013).

¹⁰² A number of bills were introduced in state legislatures to create foreclosure mediation programs but they have not passed: Wisconsin Senate Bill 255, introduced in August 2009; Massachusetts House Bill 4003, introduced in February, 2009; Texas Senate Bill 1475 and House Bill 3426, introduced in March 2009. GEOFF WALSH, NAT'L CONSUMER LAW CTR., STATE AND LOCAL FORECLOSURE MEDIATION PROGRAMS: UPDATES AND NEW DEVELOPMENTS 11-14 (2010).

¹⁰³ While there is variation among the programs, generally the branch of government that created the program is related to the dominant form of foreclosure used in the state (judicial or non-judicial) as well as the objectives of the program.

¹⁰⁴ The Supreme Court of Ohio, for example, developed an eleven-step model framework for a foreclosure mediation program but left the decisions regarding program implementation to each local jurisdiction. This framework approach proved successful because not every county had enough mediators for all the cases, or the money to pay them. *See* Kevin Kemper, *Courts*

foreclosure program for local courts to adopt. While Ohio allowed local courts to modify the model according to available resources and local needs, Florida required all local courts to implement the same model across the state despite huge variability in local housing markets.¹⁰⁶ However, after a little less than two years, the Supreme Court of Florida terminated the statewide program,¹⁰⁷ due in large part to local courts' inability to implement the model program.¹⁰⁸ In light of the experiences in Ohio and Florida, a strong model program should be provided to local courts but there should be some flexibility to allow for successful implementation. And third, when a judiciary creates a program, its choices for administering the program are limited either to pre-existing judicial infrastructure or third-party vendors.¹⁰⁹ Judiciaries, unlike

Trying Foreclosure Mediation, COLUMBUS BUS. FIRST (Dec. 24, 2007), <http://www.bizjournals.com/columbus/stories/2007/12/24/story1.html?page=all>.

¹⁰⁵ Final Report and Recommendations on Residential Mortgage Foreclosure Cases at 2, Administrative Order No. AOSC09-54 (Fla. Sup. Ct. Dec. 28, 2009) [hereinafter Fla. Admin. Order No. AOSC09-54], available at http://www.floridasupremecourt.org/pub_info/documents/AOSC09-54_Foreclosures.pdf.

¹⁰⁶ The uniform, statewide managed mediation program attempted to impose basic standards for the multiple foreclosure diversion programs that had previously sprung up around the state with widely varying structures and rules. See JAKABOVICS & COHEN, *supra* note 9, at 22; see also Administrative Order Establishing Circuit-Wide Homestead Foreclosure Conciliation Program, No. 2008-15.1 (Fla. Cir. Ct. 12th Nov. 25, 2008), available at <http://foreclosureacademytraining.com/wp-content/uploads/2011/10/AO-08-15.1-November-8-2008.pdf>.

¹⁰⁷ Managed Mediation Program for Residential Mortgage Foreclosure Cases, Administrative Order No. AOSC11-44 (Fla. Sup. Ct. Dec. 19, 2011), available at http://www.floridasupremecourt.org/pub_info/documents/foreclosure_orders/12-19-2011_Order_Managed_Mediation.pdf. The Supreme Court of Florida cited the Task Force's report, which

identified lack of communication between plaintiffs and borrowers as the most significant issue impeding early resolution of foreclosure cases, and concluded that effective case management and mediation techniques are the best methods the courts can employ to ensure that such communications occur early enough in the case to avoid wasted time and resources for the courts and the parties.

Fla. Admin. Ord. AOSC09-54, *supra* note 105, at 2; see also WALSH, *supra* note 102, at 63.

¹⁰⁸ Implementation problems include lack of loan servicer compliance with the requirements of the model program and insufficient publicity. Letter from William D. Palmer, Chair of Assessment Workgroup, to Charles T. Canady, Chief Justice, Supreme Court of Fla., Re: Managed Mediation Program for Residential Mortgage Foreclosure Cases 4 (Oct. 21, 2011) [hereinafter Palmer Letter], available at http://www.floridasupremecourt.org/pub_info/documents/Foreclosure/10-21-2011_Workgroup_Final_Report.pdf.

¹⁰⁹ In Delaware, the judiciary oversees the administration of the foreclosure mediation program itself, relying on pre-existing court personnel to handle scheduling of mediation sessions and to determine who is qualified to mediate. Although the Delaware legislature recently codified the state judiciary's administrative directive 2011-2, the judiciary still administers the program. DEL. CODE ANN. tit. 10, § 5062C (2012). In Florida, the judiciary contracted out the responsibility of administering and implementing the statewide-managed mediation program to third-party providers. Qualifying providers included non-profit organizations "independent of the judicial branch, capable of sustained operation without fiscal impact to the courts, [and] politically and professionally neutral" with a "demonstrated ability to efficiently manage the extremely high volume of foreclosure actions." Guidance

legislatures, cannot draw in other government entities to help with collecting statistics for program evaluation,¹¹⁰ or handle payments (due to statutory restrictions on the judiciary's ability to collect fees from ADR).¹¹¹

State legislatures or city councils¹¹² have a lengthy political process¹¹³ but, because legislatures control the purse strings and have the power to deploy more state resources than the judiciary, programs created by the legislature have the potential to be much more expansive and perhaps more effectively administered.¹¹⁴ Legislatures in both nonjudicial foreclosure jurisdictions¹¹⁵ and judicial foreclosure

Concerning Managed Mediation Programs for Residential Mortgage Foreclosure Cases, Administrative Order No. AOSC10-57 (Fla. Sup. Ct. 2010) [hereinafter Fla. Admin. Order No. AOSC10-57], available at <http://www.floridasupremecourt.org/clerk/adminorders/2010/AOSC10-57.pdf> (quoting Fla. Admin. Order No. AOSC09-54, *supra* note 105, at 3–5).

¹¹⁰ See, e.g., Del. Admin. Directive 2011-2, *supra* note 96 (replacing rescinded administrative directive No. 2009-03, and charging the Community Legal Aid Society, Inc. (CLASI) with maintaining statistics on how many workouts occur in mediations and the numbers of qualified homeowners who participate). Florida also had third-party providers collect limited information about the mediation session outcomes and report back to the Court. See Fla. Admin. Order No. AOSC10-57, *supra* note 109, at 3–5 (citing Fla. Admin. Order No. AOSC09-54, *supra* note 105, at 4–5).

¹¹¹ FLA. STAT. § 44.108 (2012). The Florida judiciary can only charge fees for mediation in family law cases and county court cases involving \$15,000 or less. Foreclosure mediation falls outside of these two categories and therefore the judiciary could not collect fees for mediations conducted in foreclosure cases nor could it receive such funds from a third-party provider.

¹¹² For example, Washington, D.C., and Providence, Rhode Island, which both created programs by city ordinance. See D.C. MUNICIPAL REGULATIONS, Ch. 26-C7 (effective Dec. 20, 2011).

¹¹³ States like Nevada, for example, have a part-time legislature that meets once every two years to pass legislation. See *Annual Versus Biennial Legislative Sessions*, NAT'L CONFERENCE OF STATE LEGISLATURES, <http://www.ncsl.org/legislatures-elections/legislatures/annual-versus-biennial-legislative-sessions.aspx> (last visited Feb. 25, 2013).

¹¹⁴ Interestingly, Hawaii's foreclosure dispute resolution program, reserved for non-judicial foreclosures only, created such extensive oversight of the non-judicial foreclosures (for example, it required lenders to provide mediators with proof and documentation of their right to foreclose and gave borrowers a right to sue under the law if the lender did not comply with the foreclosure mediation process) that Fannie Mae and Freddie Mac took advantage of a recent nonjudicial-to-judicial foreclosure conversion law and converted all of its foreclosures to judicial foreclosure proceedings, thereby avoiding the mediation process entirely. See *Nonjudicial Foreclosure Conversion Frequently Asked Questions*, HAW. STATE JUDICIARY, http://www.courts.state.hi.us/self-help/foreclosure/foreclosure_conversion_faqs.html (last visited Feb. 25, 2013).

¹¹⁵ Only two primarily nonjudicial foreclosure jurisdictions established foreclosure mediation programs through the judiciary. One, in the First Judicial District of New Mexico, applies only to owner-occupied, residential foreclosures before the court. N.M. Admin. Order No. 2009-00001, *supra* note 93. The other, New Hampshire's Judicial Branch Mediation Program to Reduce Foreclosures was a purely voluntary program that made trained court mediators available to all parties who wanted to participate in a mediation session, even if the foreclosure was not before a court. The program was discontinued in October, 2011. See *Office of Mediation and Arbitration—Foreclosure Mediation Program*, N.H. JUDICIAL BRANCH, <http://www.courts.state.nh.us/adrp/foreclosure/structure.htm> (last visited Feb. 25, 2013).

jurisdictions¹¹⁶ have included an ADR process in state foreclosure proceedings. Programs created by legislatures can utilize other parts of the state apparatus¹¹⁷ to administer the program, conduct homeowner outreach, provide housing counseling and legal assistance, and also regulate loan servicer conduct, as will be discussed in subsequent sections.

Thus, the branch of government that creates the foreclosure ADR program impacts both the scope and the implementation of the program. Certainly, in judicial foreclosure states, a judiciary may be able to move more quickly than the state legislature to put in place a program that will be available to all homeowners facing foreclosure and that utilizes existing infrastructure. The judiciary already controls the foreclosure process through the courts and need not rely upon the political will of the legislature to overcome the resistance of business interests or make changes or adjustments quickly. Without the support and funding of the legislature, the judiciary may not have the resources at hand to create and administer an effective mediation diversion program.

B. *Mediation and the Foreclosure Timeline*

Although foreclosure ADR programs should provide sufficient time and opportunity for negotiation, they must also maintain efficiency and appreciate their impact on the regular foreclosure process. It is crucial for state and local governments to consider the point at which foreclosure ADR programs introduce negotiation, the duration of negotiations, and the impact of negotiation on the conventional foreclosure process. A single mediation session can last two hours¹¹⁸ or

¹¹⁶ Connecticut, for example, a judicial foreclosure state, was the first state to pass legislation establishing mediation in foreclosure proceedings. The decision to use mediation as the medium for negotiations between homeowners and loan servicers was made for practical reasons. A pre-existing judicial mediation program for resolving landlord-tenant disputes had been effective in the state's Housing Courts because it created an opportunity for a fair and informed negotiation between the parties with the assistance of a neutral third party. CONN. GEN. STAT. § 47a-69 (2013). Because Connecticut's Judiciary was already familiar with the mediation model from the Housing Courts, it was not difficult to replicate in the foreclosure context. The program began operating in a matter of months (legislation creating the program passed on May 5, 2008 and the first mediations occurred two months later on July 1, 2008).

¹¹⁷ Programs created by state statute can be administered and implemented by administrative agencies, courts, their delegates, or a combination thereof. For example, Maryland's foreclosure mediation program is run by the Office of Administrative Hearings, an independent executive state agency that conducts administrative hearings. MD. CODE ANN., REAL PROP. § 7-105.1 (West 2012). Hawaii's ADR program is run by the Department of Commerce and Consumer Affairs in conjunction with the state judiciary's Center for Alternative Dispute Resolution. HAW. REV. STAT. § 667-73 (2012).

¹¹⁸ See, e.g., MD. CODE ANN., REAL PROP. § 7-105.1 (West 2012).

longer¹¹⁹ and some jurisdictions allow parties to negotiate for months over multiple mediation sessions.¹²⁰ If the goal of the program is to maximize the likelihood of a homeowner retaining the home, negotiations should begin before the loan servicer has passed a point of no-return on the road to foreclosure. Programs should also set a finite period of time for negotiations during which time the foreclosure process is suspended.

The point at which foreclosure mediations occur along the default-to-foreclosure timeline varies from jurisdiction to jurisdiction. Programs can bring loan servicers and borrowers to the negotiation table before a foreclosure has been filed, while the foreclosure action is pending, or during the redemption period after the foreclosure but before the foreclosure sale. Some programs prohibit lenders and loan servicers from initiating foreclosure until they have attempted to negotiate in mediation¹²¹ while others will stay foreclosure proceedings so that a foreclosure sale cannot be pursued as the parties concurrently negotiate potential foreclosure alternatives.

1. When Mediation Occurs in the Foreclosure Timeline

Some jurisdictions introduce foreclosure mediation early, after the borrower is in default and before the lender has taken steps to initiate the foreclosure process. In Washington, a nonjudicial foreclosure state, before a loan servicer can proceed with foreclosure, the lender must make efforts to contact the homeowner by letter and by telephone¹²² to inform him that the opportunity exists to meet and confer and he should contact a housing counselor or attorney.¹²³ Homeowners in Washington can also request mediation after receiving the loan

¹¹⁹ See, e.g., WASH. REV. CODE § 61.24.163(17) (2013).

¹²⁰ For example, Cook County, Illinois, mortgage foreclosure mediation program, which requires all parties to attend a minimum of two mandatory mediation sessions. Letter from Dorothy Kiric Kinnaird, Presiding Judge, Chancery Div., to The President and Members of the Cook Cnty. Bd. of Comm'rs 2 (July 26, 2010), available at <http://suffredin.org/pdfs/fy10q2%20foreclosure%20update.pdf>.

¹²¹ E.g., D.C. CODE § 42-815(b) (2012).

¹²² WASH. REV. CODE § 61.24.031(1)(b) (2012).

¹²³ Washington's mediation program is only available to homeowners who have been referred to mediation by a housing counselor. If the homeowner fails to respond within thirty days, then the servicer may proceed with sending the notice of default that triggers the foreclosure process. *Id.* § 61.24.031(1)(d). If the homeowner does respond to the loan servicer and requests a meeting or is referred to mediation by a housing counselor, then the borrower and loan servicer have ninety days from the time initial contact is mailed to attempt to reach a resolution. *Id.* § 61.24.031(4). Housing counselors have a duty under the law to attempt to reach resolution within the ninety day period between the date of the lender's initial contact and the date the notice of default is issued. *Id.* § 61.24.160(1)(a).

servicer's notice of default.¹²⁴ If no mediation request is made, then the lender proceeds with scheduling the foreclosure sale and providing the homeowner with notice of the sale date.¹²⁵ If the homeowner does request mediation, then the recording of the foreclosure sale is postponed until after the mediation process concludes and the mediator issues a certificate stating the mediation has been completed.¹²⁶ In a nonjudicial foreclosure state, the timeline for a foreclosure proceeding with an ADR component is the same as the timeline for a conventional foreclosure because the mediations must be completed in the regular notice period. The primary difference in Washington is that the loan servicer has an obligation under the new law to contact the borrower thirty days before issuing a notice of default, the event which triggers the homeowner's eligibility for housing counseling and mediation.¹²⁷

There are advantages to having the ADR option early in the foreclosure process. First, the loan servicer may not be so invested in the foreclosure process because it has not yet had to pay the upfront costs involved in servicing a delinquent loan and preparing the foreclosure (costs that, depending on the pooling and servicing agreement with the investor trust, the servicer may only be able to recoup upon foreclosure sale and that it will not be able to recoup if the loan instrument is modified).¹²⁸ Furthermore, the penalties and late fees that attach to a borrower's delinquent loan likely will not have accumulated to such an extent that the loan cannot be cured. Thus, the sooner the borrower and loan servicer are brought together, the more likely it is that the loan servicer's interest in being reimbursed for its servicing costs via foreclosure will not be in conflict with the investors' interest in restoring the loan as a performing investment and the borrower's interest in remaining in the home.

Second, a homeowner's circumstances may be such that she cannot produce enough income to make regular loan payments under a modified loan structure. In this case, non-retention options that are alternatives to foreclosure, such as a deed in lieu of foreclosure or a short sale, can be discussed in mediation. It is unlikely that a loan servicer would entertain these alternatives after it has already paid the out-of-pocket expenses involved in initiating foreclosure; the earlier the

¹²⁴ *Id.* § 61.24.030(8)(k). In these situations, the borrower has thirty days after receipt of a notice of default to request mediation.

¹²⁵ *Id.*

¹²⁶ *Id.* § 61.24.163(13).

¹²⁷ See *Washington Foreclosure Process and Timelines*, WASH. STATE OFFICE OF THE ATTORNEY GEN. (July 26, 2009), http://www.atg.wa.gov/uploadedFiles/Home/Safeguarding_Consumers/Consumer_Issues_A-Z/Foreclosures/Foreclosurereimbursement.pdf.

¹²⁸ See THOMPSON, *supra* note 32, at 16–18, 25–29. These costs include title searches, drive-by inspections, and principal or interest payments that the loan servicer must advance to the trustees, even if the loan is delinquent.

homeowner can sit down with a lender for a frank and realistic assessment of the likelihood of retaining the home, the better.

However, one potential disadvantage to having the mediation early is that the homeowners have less time to consult an attorney or housing counselor who can help evaluate the borrower's options, identify federal and state assistance programs, estimate the current value of the house, and explore other ways to boost the homeowner's income. Some mediation programs with an early mediation option overcome this potential disadvantage by requiring homeowners to meet with housing counselors prior to mediation.¹²⁹

Other jurisdictions introduce ADR as an option only after the foreclosure process has begun. Illinois' Cook County, which includes Chicago and the surrounding metropolitan area, is a judicial foreclosure jurisdiction that created its foreclosure mediation program by judicial rule. According to the rule, when a lender files a Complaint for Mortgage Foreclosure, it receives a date for a special "Initial Case Management Conference."¹³⁰ Before this Initial Case Management Conference, scheduled for two months after the lender files, homeowners are connected with housing counselors and volunteer attorneys who review the homeowner's case and help the homeowners complete, if appropriate, a Motion for Referral to Mortgage Foreclosure Mediation.¹³¹ When the homeowner appears in court for the sixty-day Case Management Conference, the court reviews the motion and, if it refers the case to mediation, then the parties have twelve weeks before they have to reappear before the court for a Post Mediation Status hearing.¹³² During this twelve-week period, a minimum of two mediation sessions are scheduled and all parties (the mediator, the homeowner, the homeowner's pro bono attorney, the loan servicer or lender representative, and lender attorney) must attend.¹³³ If an agreement is reached in mediation, then the agreement is presented to the court and the foreclosure action is dismissed according to the agreed

¹²⁹ For example, Maryland recently changed its laws to include a pre-filing mediation option. Under this law, homeowners who elect to participate in early mediation must consult a housing counselor. 2012 Md. Laws 1053 (amending MD. CODE ANN., REAL PROP. § 7-105.1(d) (2012)).

¹³⁰ Mortgage Foreclosure Mediation Program, Gen. Admin. Order No. 2010-01, (Il. Cir. Ct. Cook Cnty. Apr. 8, 2010), *available at* <http://www.suffredin.org/pdfs/foreclosure.administrative.order.2010-01.pdf>.

¹³¹ TIMOTHY C. EVANS & MOSHE JACOBUS, CIRCUIT COURT OF COOK CNTY., IL., MORTGAGE FORECLOSURE MEDIATION PROGRAM: REPORT AND UPDATE 14 (2011), *available at* <http://www.cookcountycourt.org/Portals/0/Chancery%20Division/Forclosure%20Mediation/Report%20to%20Commissioners%205-3-2011.pdf>.

¹³² *Id.* at 14–16.

¹³³ *Id.* at 17.

terms. If no agreement is reached, then the foreclosure proceeds along the normal litigation track.¹³⁴

Jurisdictions that have a lengthy right of redemption period also give borrowers the right to request mediation with their lender even after the foreclosure has been finalized. In Vermont, for example, a lender is not permitted to sell a foreclosed residential property immediately after foreclosing and taking legal title to the property. Rather, the lender must hold off selling the property for a six-month redemption period, during which time the homeowner can recover the property by paying the full amount owed on the loan.¹³⁵ Homeowners in Vermont may request mediation with the loan servicer during this six month period;¹³⁶ however, the program rules state explicitly that a court has the right to shorten the redemption period or deny the mediation request if it believes the request is being made as a delaying tactic.¹³⁷

The time it takes for a foreclosure to run from default notice to sale is important for lenders and borrowers. For homeowners, the time between default notification and sale is important because the longer the delay, the more interest, fees, and penalties will accrue, making it difficult to achieve a sustainable modification. If foreclosure is unavoidable, the additional costs will ultimately be deducted from the proceeds of the foreclosure sale or attached personally to the foreclosed homeowner as deficiency judgments. For lenders, the picture is more complicated. A lender foreclosing on a house that is likely to sell for the full value of the loan has an incentive to move the foreclosure process along quickly. A lender foreclosing on a house that is overleveraged or unlikely to sell may have an incentive to delay the foreclosure process and put off responsibility for maintaining and securing a vacant home for as long as possible.¹³⁸

Including foreclosure mediation in the foreclosure process does not negatively impact one party or another by extending the overall foreclosure timeline by any considerable amount of time.¹³⁹ Mediations

¹³⁴ *Id.*

¹³⁵ 2012 Vt. Acts & Resolves, Act No. 102.

¹³⁶ See VT. STAT. ANN. tit. 12, § 4632(b) (2012) (“[A]ll mediation shall be completed prior to the expiration of the redemption period. The redemption period shall not be stayed on account of pending mediation.”).

¹³⁷ *Id.* § 4632(a).

¹³⁸ The Federal Housing Finance Agency’s “REO to Rental” program attempts to move real estate owned properties held by Fannie Mae, Freddie Mac, and the Federal Housing Administration to qualified, private investors. See Press Release, Fed. Hous. Fin. Agency, FHFA Announces Interested Investors May Pre-Qualify for REO Initiative (Feb. 1, 2012), available at <http://www.fhfa.gov/webfiles/23196/REO2112F.pdf>.

¹³⁹ The National Consumer Law Center (NCLC), citing RealtyTrac, reports that foreclosures nationwide took an average of 336 days to complete, with states like New York, New Jersey, and Florida taking over two years. WALSH, *supra* note 38, at 38. NCLC points out in its white paper *Rebuilding America* that the unprecedented foreclosure delays in 2010 and 2011 had little, if anything, to do with the foreclosure conference and mediation programs. *Id.*

occurring before or concurrently with foreclosure filing will more likely lead to modification since the smaller the delinquency period the greater the chance of curing the loan. There appears to be no disadvantage to permitting foreclosure mediation during the redemption period. However, by the time the redemption period begins, a home retention agreement is unlikely to occur because the loan servicer has expended resources to foreclose—resources that can only be recouped from the investor trust through foreclosure.

2. Does Mediation Stay or Prevent Foreclosure?

Jurisdictions must also determine what impact, if any, an ADR process will have on the conventional foreclosure proceeding. Some jurisdictions prevent loan servicers from initiating foreclosure until they have participated in mediation and the mediation process has concluded.¹⁴⁰ Others jurisdictions place a stay on the foreclosure process while the parties are in mediation by preventing servicers from recording the foreclosure sale until the parties complete mediation.¹⁴¹ A third group of jurisdictions is silent as to whether a loan servicer may pursue foreclosure while negotiating foreclosure alternatives.¹⁴² If the purpose of mediation is for parties to commit to a serious discussion about alternatives, it is inconsistent to allow a loan servicer simultaneously to pursue foreclosure and negotiate an alternative. Loan servicers pursuing foreclosure appear disingenuous and erode borrower confidence that the loan servicer is participating in mediation in good faith.¹⁴³

A related question is what happens to the foreclosure timeline if a contingent or temporary modification agreement is reached during a foreclosure mediation or settlement. A contingent agreement might be one in which the loan servicer agrees to modify the homeowner's loan if

¹⁴⁰ See, e.g., OR. REV. STAT. § 86.735(5)(b) (2012). The Foreclosure Avoidance Mediation Program in Oregon, a nonjudicial foreclosure state, prohibits lenders from initiating foreclosure until they have participated in the program and can show either that the borrower is ineligible for any foreclosure alternatives or "is not in compliance with the terms of a foreclosure avoidance measure." *Id.*

¹⁴¹ See, e.g., WASH. REV. CODE § 61.24.031(16)(a) (2012) (prohibiting a lender from recording a notice of foreclosure sale until the lender receives a certificate from the mediator stating that mediation has been successfully completed).

¹⁴² See, e.g., ADMIN. OFFICE OF THE CTS., NEW JERSEY FORECLOSURE MEDIATION 2 (2012), available at http://www.judiciary.state.nj.us/civil/foreclosure/11290_foreclosure_med_info.pdf. For a sample form of foreclosure mediation instructions for homeowners seeking a stay of a sheriff's sale and mediation, see STAY OF SHERIFF'S SALE NOTICE OF MOTION INSTRUCTIONS, CATALOG NO. 11277 (2013), available at <http://www.judiciary.state.nj.us/forms.htm#foremed>.

¹⁴³ See generally ALON COHEN, CTR. FOR AM. PROGRESS, WALK THE TALK: BEST PRACTICES ON THE ROAD TO AUTOMATIC FORECLOSURE MEDIATION (2010), available at http://www.americanprogress.org/wp-content/uploads/issues/2010/11/pdf/walk_the_talk.pdf.

the homeowner resubmits a completed loan modification application or if the homeowner successfully completes a three-month trial modification period. Contingent agreements prove problematic because parties exit the mediation process without final resolution and may not be able to conclude negotiations without the structure of a mediation program. Jurisdictions handle the challenge of contingent or temporary agreements differently. In Connecticut, some judges hold the case in mediation until the contingency is met and a final loan modification is executed.¹⁴⁴ This means a case may be stalled and unresolved for weeks or sometimes months. In Maryland, administrative law judges have the authority as mediators to continue the mediation for a second session so that the parties have an opportunity to return to the negotiating table and finalize an agreement; however, that second session has to occur within the sixty day statutory time period for mediation.¹⁴⁵ Beyond that time, the mediation program cannot provide oversight for any continuing negotiations. Nevada's foreclosure mediation program, which also restricts the entire mediation process to a statutory timeframe, resolves this problem by requiring all contingent or temporary agreements to include an expiration date certain.¹⁴⁶ Therefore, if a loan servicer fails to grant the permanent modification after the borrower successfully completes the trial period or a homeowner fails to provide necessary documentation by the agreed upon date, the other party has a cause to petition for judicial review.¹⁴⁷

Parties should be given adequate time and opportunity to engage seriously in discussions about alternatives to foreclosure and to come to a resolution. Prohibiting loan servicers from pursuing foreclosure while they are in negotiations with borrowers is one way to ensure that loan servicers do not turn automatically to foreclosure without first taking the time to evaluate other loss mitigation or non-retention options with the borrower. However, once parties enter mediation, the stay on foreclosure should not be indefinite. Allowing parties to meet as often as necessary within a strict timeframe discourages both parties from using the mediation process as a delay tactic. Furthermore, restricting contingent or temporary agreements promotes a final settlement of the delinquent loan. Contingent agreements should have expiration dates, or a date certain by which the parties shall have complied with their

¹⁴⁴ *Public Hearing on H.B. 5410 Before the Banks Comm.*, 2010 Leg., 2010 Reg. Sess. (Conn. 2010) (statement of Rep. Ryan Barry on the equitable powers of judges presiding over foreclosure cases).

¹⁴⁵ *Foreclosure Mediation*, MD. OFFICE OF ADMIN. HEARINGS, <http://www.oah.state.md.us/foreclosuremediation.asp> (last visited May 19, 2013).

¹⁴⁶ NEV. FORECLOSURE MEDIATION R. 16(1).

¹⁴⁷ The foreclosure settlement program in Cook County, Illinois, requires agreements for a trial modification to contain language that, upon successful payment, the modification automatically becomes permanent. EVANS & JACOBUS, *supra* note 131, at 22–23.

obligations, and contingent agreements should include language making them permanent upon satisfaction of the contingency.

C. *Homeowner Enrollment: Automatic, Opt-In, and Triage*

There are three different models for enrolling homeowners in foreclosure ADR programs. Some jurisdictions automatically send all parties to a foreclosure action to a mediation or settlement program, some require the borrower to affirmatively request to participate in a program, and yet others use housing counselors as gatekeepers to screen borrowers and refer those who are eligible to the program. There are advantages and challenges to consider in each approach. Nevertheless, no matter the trigger for homeowner enrollment, programs that make concerted efforts to reach borrowers and educate them about the foreclosure process and mediation will likely have greater impact.

Programs with automatic enrollment send parties to a foreclosure proceeding directly to mediation. Automatic enrollment has the effect of boosting homeowner participation. New York's statewide program automatically sends homeowners with mortgages and lenders to an early, mandatory settlement conference presided over by judges, hearing officers, or a court attorney "referee."¹⁴⁸ Once a foreclosure action is filed in the court, the court sends the homeowner a court summons with the date, time, and place of the settlement conference as well as the date, time, and place of a required meeting with a court housing counselor.¹⁴⁹

In contrast, opt-in programs require that the borrower first request to participate in a foreclosure mediation or settlement conference. However, borrower participation in an opt-in program hinges upon whether the borrower has been properly notified about the possibility of participating in the first place. Many jurisdictions publicize foreclosure mediation to borrowers by requiring loan servicers to include information about mediation in official notices sent to borrowers about

¹⁴⁸ See ANN PFAU, STATE OF N.Y. UNIFIED COURT SYS., 2010 REPORT OF THE CHIEF ADMINISTRATOR OF THE COURTS 3 (2010), available at <http://www.courts.state.ny.us/publications/pdfs/foreclosurereportnov2010.pdf>.

¹⁴⁹ For a sample notice from the court, see *id.* app. 2. Providence, Rhode Island, which uses a nonjudicial foreclosure procedure, also requires all parties to a residential mortgage foreclosure to attend, or at least attempt to attend, mandatory conciliation conferences with approved housing counselors before a foreclosure deed can be recorded. PROVIDENCE, R.I., CODE OF ORDINANCES § 13-216 (2011). The original ordinance, Providence, R.I., Ordinance No. 340, ch. 2009-41, § 1 (July 27, 2009), denied lenders the ability to record a foreclosure deed in the land evidence records until they could present a certificate showing they had attended the conciliation conference and negotiated in good faith, *id.* This section of the ordinance was struck down by the Rhode Island Superior Court in *Deutsche Bank National Trust v. City of Providence*, P.C. No. 10-1240, 2010 R.I. Super. LEXIS 81 (R.I. Super. Ct., May 17, 2010), and a new ordinance with a revised penalty was issued, Providence, R.I., Ordinance No. 18, ch. 2010-2, § 1 (Jan. 21, 2010).

the delinquent loan and impending foreclosure proceedings.¹⁵⁰ Other jurisdictions do not rely solely upon the lenders' communications to get the word out to borrowers but also have a third party, either a government agency or a housing counselor, contact homeowners about participating in mediation.¹⁵¹

Yet a third category of programs uses court administrators or designated housing counselors to screen homeowners for program eligibility. Ohio's model mediation program suggests that the local court's mediation department screen all mediation requests for borrower eligibility before referring the case to foreclosure mediation.¹⁵² Although the model suggests criteria for borrower eligibility, each local court can determine its own eligibility standards depending on its available resources.¹⁵³ Another screening approach uses housing counselors to triage ineligible borrowers and refer eligible borrowers to mediation. Similarly, Washington's statewide program requires loan servicers to send a Notice of Pre-foreclosure Options informing delinquent borrowers of the availability of housing counselors and also that, if they do not contact a housing counselor or attorney, then they may lose the opportunity to participate in mediation.¹⁵⁴ Once a homeowner contacts a housing counselor, the counselor must review the homeowner's circumstances and assess eligibility for mediation.¹⁵⁵ If

¹⁵⁰ In Vermont, for example, servicers must "state the importance of participating in mediation even if the homeowner is currently communicating" with the lender or loan servicer in the notice of the foreclosure action. VT. STAT. ANN. tit. 12, § 4632(c)-(d) (2012).

¹⁵¹ For example, Hawaii's nonjudicial foreclosure dispute resolution program requires loan servicers to include in their foreclosure notices an explanation that the lender has a duty under the law "to attempt to avoid foreclosure or to mitigate damages where foreclosure is unavoidable," and that the lender is required, upon election by the homeowner, to participate in the foreclosure dispute resolution program. HAW. REV. STAT. § 667-75(a) (2012). The servicer must also send a copy of the foreclosure notice to the State's Department of Commerce and Consumer Affairs, which then independently mails information regarding the availability of the dispute resolution program to the borrower along with the forms to elect or waive participation in the program. *Id.* §§ 667-76(a), 667-77.

¹⁵² SUPREME COURT OF OHIO, FORECLOSURE MEDIATION PROGRAM MODEL 18 (2008), available at http://www.nclc.org/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/ohio_prgm_model.pdf.

¹⁵³ The model suggests that, at a minimum, homeowner eligibility for foreclosure mediation should depend on whether the borrower filed an answer or alternative pleading with the court, sent a request for mediation to the program administrator, and indicated that the homeowner is currently residing, and would like to remain, in the property subject to foreclosure. *Id.*

¹⁵⁴ WASH. REV. CODE § 61.24.031(1)(c) (2012).

¹⁵⁵ *Id.* § 61.24.160(3). Eligibility criteria include the following: the property is currently owner-occupied; the lender is not exempt under the Foreclosure Fairness Act; the homeowner has received notice either of the pre-foreclosure options or of default; and if the homeowner is in bankruptcy, then bankruptcy has been stayed or the homeowner has consented to negotiate a modification of the mortgage. STATE OF WASH. DEP'T OF COMMERCE, FORECLOSURE FAIRNESS PROGRAM: ELIGIBILITY CRITERIA & GUIDANCE FOR REFERRALS TO MEDIATION (2012), available at <http://www.commerce.wa.gov/Documents/FFP-REFERRAL-ELIGIBILITY-GUIDANCE-Dec-2012-Update.pdf>. Compare these to Delaware's initial program eligibility criteria, which require homeowners to show they could reasonably sustain monthly mortgage payments (including

a housing counselor concludes that a homeowner is eligible for mediation, the housing counselor sends a notice to the borrower and Washington's Department of Commerce stating that mediation is appropriate.¹⁵⁶ From there, the Department selects a mediator and notifies the parties.¹⁵⁷

There are advantages and challenges in all three options. Programs that automatically send parties to foreclosure mediation have a far higher percentage of participating borrowers.¹⁵⁸ That means many more homeowners are being evaluated for loan modifications or non-retention alternatives to foreclosure. Even if parties automatically sent to mediation do not come to an agreement in mediation, at least the homeowner now has the contact information for a person who works for the loan servicer and has the authority to settle the case. However, programs with such a high volume of cases have the potential to be more costly because they require more administrative oversight and may not be able to filter out those cases that are not appropriate for mediation, wasting resources as a consequence. Conversely, opt-in programs that require borrowers to affirmatively request mediation have many fewer cases, thereby requiring less administrative oversight, but they may not be reaching those homeowners who are not already proactively engaged in reaching out to their loan servicer. If lack of initiative on the part of homeowner and lack of communication on the part of the loan servicer is one of the problems foreclosure mediation seeks to resolve, then it does not make sense for participation in foreclosure mediation to require the same initiative and communication that has been lacking from the start.

The third alternative, which uses housing counselors as gatekeepers for mediation, appears to be the best way to maximize the advantages and minimize the challenges of the other two approaches. Attaching housing counseling as a precursor to mediation ultimately makes negotiations more efficient and equitable because the homeowners head into mediation informed about their options and equipped with knowledge that can help level the playing field at the negotiation table. An educated borrower may not waste time seeking outcomes that are

taxes, principal, interest, insurance, homeowner association dues, and other fees typically placed in escrow) that were thirty-eight percent, or less than the homeowner's gross (pretax) monthly income. Del. Admin. Directive No. 2011-2, *supra* note 96, at 4.

¹⁵⁶ WASH. REV. CODE § 61.24.163(2) (2012).

¹⁵⁷ *Id.* § 61.24.163(3)(b).

¹⁵⁸ The Center for American Progress reports that programs with automatic mediation have close to seventy-five percent of homeowners facing foreclosure participate, while opt-in programs rarely have more than twenty percent of homeowners facing foreclosure participating. ALON COHEN & ANDREW JAKBOVICS, CTR. FOR AM. PROGRESS, NOW WE'RE TALKING: A LOOK AT CURRENT STATE-BASED FORECLOSURE MEDIATION PROGRAMS AND HOW TO BRING THEM TO SCALE 7 (2010), available at http://www.americanprogress.org/wp-content/uploads/issues/2010/06/pdf/foreclosure_mediation.pdf.

unrealistic or economically unfeasible. Loan servicers also stand to benefit when borrowers work with housing counselors before entering negotiation because it is more likely that the borrower will properly complete and submit completed loan modification applications that the loan servicer can review prior to the mediation and allow for an actual negotiation. Lenders also benefit if a profitable loss-mitigation option is put in place and the mortgage continues to provide a profitable return on their investment as a result of informed negotiations. Finally, courts in judicial foreclosure states benefit from using housing counselors instead of court administrators to screen cases, saving the court from additional administrative burdens.¹⁵⁹

No matter how homeowners are enrolled in a foreclosure ADR program, reaching homeowners and informing them in terms they can understand about opportunities for a facilitated negotiation with their loan's servicer or lender is crucial to a program's success. Many homeowners do not open and read through the stacks of materials sent by lenders and many may be suspicious about loan servicers' overtures to mediate.¹⁶⁰ Therefore, communications from neutral third parties, such as the courts or another administrative agency, in addition to the notices borrowers receive from lenders, may be an effective way to engender trust in borrowers. Some of the more successful mediation and settlement programs have engaged in extensive public outreach campaigns to reach borrowers.¹⁶¹ In Philadelphia, for example, an outreach team of volunteers from grass roots organizations went door to door to homeowners who had received notices of foreclosure but had not yet called the program hotline. Equipped with cellular mobile phones, the volunteers would explain the program in person to the homeowners and then had the homeowner call the hotline while the volunteer waited at the front door.¹⁶² As a result, ninety percent of homeowners facing foreclosure participated in the city's settlement program.¹⁶³

¹⁵⁹ See COHEN, *supra* note 143, at 16.

¹⁶⁰ Florida's program was also poorly publicized, and borrowers were unsure of its legitimacy. See Palmer Letter, *supra* note 108, at 4.

¹⁶¹ Judges and court staff in Queens County, New York, "participated in evening and weekend programs to inform the public about court procedures under the legislation as well as the availability of housing counseling and legal services." See PFAU, *supra* note 148, at 8. The Ohio Department of Commerce launched "Save the Dream" as a public awareness campaign with advertisements on radio and television, a user-friendly website, and a free telephone hotline with information and access to an approved housing counselor. See, e.g., *Foreclosure Mediation*, CUYAHOGA CNTY. COMMON PLEAS COURT, <http://cp.cuyahogacounty.us/internet/ForeclosureMediation.aspx> (last visited Jan. 9, 2013).

¹⁶² See JAKABOVICS & COHEN, *supra* note 9, at 19; THE REINVESTMENT FUND, PHILADELPHIA RESIDENTIAL MORTGAGE FORECLOSURE DIVERSION PROGRAM: INITIAL REPORT OF FINDINGS 3 (2011), available at http://www.trfund.com/resource/downloads/policypubs/Foreclosure_Diversion_Initial_Report.pdf.

¹⁶³ COHEN, *supra* note 143, at 20.

D. *Third-Party Facilitator Qualifications, Responsibilities, and Confidentiality*

State and local governments seeking to effectively and efficiently resolve communication barriers, educate borrowers, and provide oversight of loan servicers' conduct should have a third-party facilitator involved in the negotiations. Indeed, almost all existing foreclosure ADR programs include a third-party facilitator.¹⁶⁴ Sometimes this person is called a "mediator" and sometimes the person is given a different label, such as, conciliation conference coordinator¹⁶⁵ or a neutral dispute resolution specialist.¹⁶⁶ Third-party facilitators can play a central role in foreclosure negotiations and, therefore, programs that utilize facilitators should ensure those individuals are qualified, appropriately trained, and clear on their role and responsibilities in the process.¹⁶⁷ One responsibility that many programs give their facilitators is to monitor parties' behavior and report on the outcomes of mediation sessions, information that is invaluable in determining whether a program is fulfilling its purpose. Programs need to make sure that requiring facilitators to report does not conflict with state laws regarding confidentiality of mediation or settlement communications.

¹⁶⁴ A few programs do not have a third party facilitator. New York automatically requires all borrowers and lenders that are parties to a residential foreclosure action to attend mandatory settlement conferences. See N.Y. C.P.L.R. 3408. Indiana gives borrowers who are the owner-occupiers of a residential property in foreclosure, and who have not had a prior loan modification, the option of requesting a settlement conference with the lender. See IND. CODE § 32-30-10.5-8 (2012). Philadelphia's program has borrowers and lenders meet in court to negotiate alternatives to foreclosure, and only when no agreement can be reached is a judge *pro tem* called in to preside over the case in a closed-door session. See Residential Mortgage Foreclosure Diversion Pilot Program, Joint Gen. Court Regulation No. 2008-01 (Pa. Ct. of C.P., Phila. Cnty., 1st Dist. 2008) [hereinafter Phila. Court Regulation No. 2008-01], available at <http://fjd.phila.gov/pdf/regs/2008/cpjgcr-2008-01.pdf>. California and Massachusetts have no formal program but require lenders to make contact with borrowers and assess foreclosure alternatives before proceeding with a foreclosure sale. See CAL. CIV. CODE §2923.5 (West 2012); MASS. GEN. LAWS ch. 244, § 35A(c) (2012). Both laws were challenged successfully in federal court and found to be preempted by the Home Owner's Loan Act of 1933. *Rodriguez v. J.P. Morgan Chase*, 809 F. Supp. 2d 1291 (S.D. Cal. 2011); *Sovereign Bank v. Sturgis*, 863 F. Supp. 2d 75 (D. Mass. 2012).

¹⁶⁵ See PROVIDENCE, R.I., CODE OF ORDINANCES §§ 13-213 (2012).

¹⁶⁶ HAW. REV. STAT. § 667-1 (2012).

¹⁶⁷ Connecticut was the first state to use mediators to facilitate foreclosure settlement negotiations. There had been a judicial mediation program in Connecticut's Housing Courts since 1978 that proved effective in resolving landlord-tenant disputes because it created the opportunity for a fair and informed negotiation between the parties with the assistance of a neutral third party. These housing specialists, later called mediators, were required to have particular knowledge of applicable laws and could also advise parties regarding availability of financial assistance. See CONN. GEN. STAT. § 47a-69(b) (2012). When the foreclosure crisis hit Connecticut, the judiciary lifted the pre-existing Housing Court mediator model and applied it to foreclosure cases. See *id.* § 47a-69(c) (allowing mediators to recommend settlements).

1. Facilitator Qualifications and Training

Some programs require facilitators to be attorneys¹⁶⁸ or judges, retired judges, or administrative law judges with mediation training.¹⁶⁹ A number of programs additionally require that attorneys also have mediation training and/or have subject matter expertise in foreclosure law.¹⁷⁰ Some facilitators have to be experienced mediators on the staff of a court's mediation office, serve on a roster of court-approved mediators,¹⁷¹ or be independent mediators.¹⁷² Only one program, the foreclosure conciliation program in Providence, Rhode Island, uses housing counselors as facilitators. Some programs also want their facilitators to have knowledge of local, community-based resources and mortgage assistance programs¹⁷³ or previous work experience in foreclosures, credit, and collections work.¹⁷⁴ Maine and Vermont further require their foreclosure mediators to know how to utilize Federal Deposit Insurance Corporation (FDIC) net present value worksheets for determining the viability of a HAMP loan modification.¹⁷⁵

Almost all programs require training, but the training ranges in content and duration.¹⁷⁶ Ohio requires those mediators with prior mediation training to take a four-and-a-half hour training on

¹⁶⁸ VT. STAT. ANN. tit. 12, § 4631(c) (2012). Vermont's foreclosure mediation program, which exists primarily as a means to assure that lenders are evaluating homeowners for HAMP eligibility, requires mediators to be attorneys licensed in the state who have completed continuing legal education courses approved by the Vermont Bar Association.

¹⁶⁹ For example, the administrative law judges who preside over foreclosure mediations in Maryland and Maine are trained mediators. MAINE REV. STAT. tit. 4, §§ 104, 157-B (2012); *id.* tit. 14, § 6321-A(7); MD. CODE ANN., REAL PROP. § 7-105.1(k)(2) (West 2012).

¹⁷⁰ See, e.g., Automatic Residential Foreclosure Mediation Program § 4, at 5, Administrative Directive No. 2012-2 (Del. Super. Ct. Jan. 13, 2012) [hereinafter Del. Admin. Directive No. 2012-2], available at http://courts.delaware.gov/Superior/pdf/Administrative_Directive_2012_2.pdf; Phila. Court Regulation No. 2008-01, *supra* note 164, § 6(a), at 3.

¹⁷¹ See Fla. Admin. Order No. AOSC10-57, *supra* note 110, at 2-3.

¹⁷² Nevada defines "experienced mediator" as someone who has "participated in a mediation training program consisting of at least 40 hours of classroom and role playing and has conducted 10 mediations as a co-mediator or sole mediator." Order on Foreclosure Mediation Rules, Rule 3 (Nev. Sup. Ct. June 30, 2009) (amending Rule 3.4(a)(2)), available at http://www.nevadajudiciary.us/images/foreclosure/adkt435_amendedrules.pdf.

¹⁷³ See, e.g., MAINE REV. STAT. tit. 14, §§ 6321-A(7)(A)(2), (7)(A)(3) (2011).

¹⁷⁴ See *Foreclosure Diversion Program Information for Potential Mediators*, STATE OF ME. JUDICIAL BRANCH, http://www.courts.state.me.us/maine_courts/fdp/mediators.html (last visited Jan. 9, 2013).

¹⁷⁵ See MAINE REV. STAT. tit. 14, §§ 6321-A(3), (7)(A)(4), (13) (2011); VT. STAT. ANN. tit. 12, § 4634(b)(4) (2012).

¹⁷⁶ For example, Florida's statewide managed mediation program provided an extensive curriculum for training foreclosure mediators. The curriculum and training standards were attached as an exhibit to the Supreme Court of Florida Administrative Order establishing the statewide managed mediation program. See Fla. Admin. Order No. AOSC09-54, *supra* note 105, exhibit A, at A-58 to A-66 (Fla. 2009).

foreclosure mediation¹⁷⁷ whereas Oregon's Foreclosure Avoidance Mediation Program training consists of three, full eight-hour days.¹⁷⁸ Most training includes basic mediation skills as well as information on mortgages, deeds of trust, promissory notes, and how to work through loan modifications and non-retention alternatives.¹⁷⁹ Some jurisdictions offer follow-up trainings to keep facilitators up-to-date on developments in the law, mortgage assistance programs, and program policies.¹⁸⁰

Because foreclosure negotiations can be both highly technical and highly emotional, and there is often a stark contrast in sophistication and experience between the parties, it is crucial that third-party facilitators have appropriate skills and training to run a fair process. Homeowners generally have only one chance to participate in a foreclosure settlement program and have little prior experience with negotiating eligibility for loan modifications or non-retention plans. Loan servicers, on the other hand, are represented in these programs by the same attorneys who negotiate on their behalf in dozens, if not hundreds, of foreclosure cases.

2. Facilitator Role and Responsibilities

Programs should also clarify the roles and responsibilities of the third-party facilitator to ensure that there is as much uniformity as

¹⁷⁷ See SUPREME COURT OF OHIO, FORECLOSURE MEDIATION TRAININGS AND ROUNDTABLES (2009), <http://www.sconet.state.oh.us/JCS/disputeResolution/foreclosure/Training.pdf>. Individuals eligible for the training must have previously completed at least twelve hours of mediation training. Nevertheless, for those mediators new to foreclosure, the foreclosure mediation training addresses quite a range of issues: the history and scope of the foreclosure crisis; relevant terminology; players and the dynamics of the foreclosure servicing industry; limitations, advantages and disadvantages for the parties in foreclosure cases and the information required from the parties to come to an agreement under a range of settlement options; analysis of the possibilities and limitations of mediation between pro se homeowners and lenders in foreclosure cases; relevant statutes and rules; the local court foreclosure mediation program processes and procedures; and, if applicable, the Supreme Court Foreclosure Mediation Program Model. *Id.*

¹⁷⁸ The training includes eight hours of foreclosure law basics, eight hours of foreclosure law for mediators, and eight hours about foreclosure avoidance mediation in practice. Order to Adopt OJD Court-Connected Mediator Qualifications Rules 10, Chief Justice Order No. 05-028 (Or. Sup. Ct. July 28, 2005), available at [http://www.ojd.state.or.us/web/OJDPublications.nsf/Files/05cER001sh.pdf/\\$File/05cER001sh.pdf](http://www.ojd.state.or.us/web/OJDPublications.nsf/Files/05cER001sh.pdf/$File/05cER001sh.pdf).

¹⁷⁹ See, e.g., Order on Foreclosure Mediation Rules, *supra* note 172, Rule 3 (amending Rule 3.4(b)). In New Jersey, the foreclosure mediators are volunteers with eighteen hours of mediation training who are required to complete a free, one-day training on working out foreclosure alternatives.

¹⁸⁰ See, e.g., HAW. DEP'T OF COMMERCE & CONSUMER AFFAIRS, ANNUAL REPORT TO THE LEGISLATURE: MORTGAGE FORECLOSURE DISPUTE RESOLUTION PROGRAM 8 (2011), available at <http://hawaii.gov/dcca/oah/mfdr/Mortgage-Foreclosure-Dispute-Resolution-Program-Report-2011.pdf>.

possible across mediations. At base, programs charge the facilitator with overseeing the negotiation process between the borrower and the lender and helping them work toward a mutually acceptable resolution. The facilitator can be present throughout the process or can be called in by the parties when needed.¹⁸¹ The way in which the facilitator runs the process is sometimes specified. For example, Ohio's foreclosure mediators use a facilitative style¹⁸² of mediation to guide the parties through a "party self-determination" process in which the mediators provide resource information but do not give advice or advocate for either party.¹⁸³ The conciliation coordinators in the City of Providence, on the other hand, function impartially but are responsible for leading the parties through an exploration of foreclosure work-out or modification options.¹⁸⁴

Some programs provide explicit instructions to mediators on what topics should be discussed in mediation. In Maine, for example, Foreclosure Diversion Program mediators are expected to lead the homeowner and lender through all issues of foreclosure including: 1) proof of ownership of the note and any assignments of the note, 2) calculation of the sums due on the note for principal, interest, and any costs or fees, 3) reinstatement of the mortgage, 4) modification of the loan, and 5) restructuring of the mortgage debt.¹⁸⁵ In the alternative, Washington's foreclosure mediators help the parties address foreclosure alternatives by having the parties consider the borrower's current and anticipated financial circumstances, compare the anticipated net recovery following foreclosure versus the value of payments under a

¹⁸¹ In Delaware, a mediator can step out of the mediation if there are multiple mediation sessions occurring simultaneously and the mediator determines that his or her presence is not required for the entire mediation session. DEL. CODE ANN. tit. 10, §5062C(i)(1) (2012); *see also* Phila. Court Regulation No. 2008-01, *supra* note 164, at 3.

¹⁸² There are many mediation "styles" (for example, evaluative, transformative, facilitative, to name some of the major ones). A mediator's style refers primarily to how the mediator orients him or herself toward the parties' problem-solving. *See* Leonard L. Riskin, *Decisionmaking in Mediation: The New Old Grid and the New New Grid System*, 79 NOTRE DAME L. REV. 1 (2003); Leonard L. Riskin, *Mediator Orientations, Strategies and Techniques*, 12 ALTERNATIVES TO HIGH COST LITIG. 111, 111-14 (1994).

¹⁸³ JACQUELINE C. HAGEROTT, FORECLOSURE MEDIATION: AN OVERVIEW (2011), available at [http://mvfairhousing.com/cle/resources/04%20Foreclosure%20Mediation%20An%20Overview%20\(Jacqueline%20Hagerott%20presentation\).PDF](http://mvfairhousing.com/cle/resources/04%20Foreclosure%20Mediation%20An%20Overview%20(Jacqueline%20Hagerott%20presentation).PDF). Nevada also explains that the mediator's role is not that of a judge or a lawyer because they neither decide how to resolve the case nor give legal advice. *See Mediator Documents*, STATE OF NEV. FORECLOSURE MEDIATION PROGRAM, <http://foreclosure.nevadajudiciary.us/index.php/documents-and-forms/mediator-documents> (last visited Mar. 6, 2013).

¹⁸⁴ CITY OF PROVIDENCE, FORECLOSURE CONCILIATION REQUIREMENT, DUTIES OF PARTICIPANTS, APPLYING THE ORDINANCE, MODEL CERTIFICATIONS (2009), <http://www.providenceri.com/efile/230>.

¹⁸⁵ *Foreclosure Diversion Program Information for Potential Mediators*, STATE OF ME. JUDICIAL BRANCH, http://www.courts.state.me.us/maine_courts/fdp/mediators.html (last visited Mar. 7, 2013).

modified mortgage loan, and run calculations under all federal mortgage relief programs.¹⁸⁶ If programs expect mediators to facilitate this kind of discussion, then the mediators must have special training and expertise.

In addition to running the foreclosure settlement process, some programs require facilitators to prepare mediation reports¹⁸⁷ and perform administrative tasks. These tasks can include scheduling the mediation session with the parties,¹⁸⁸ collecting documents, and referring the borrower to housing counseling.¹⁸⁹ Mediation reporting requirements vary widely. Some states require a report from the third-party facilitator. Depending on the jurisdiction, this report is sent directly to the court or dispute resolution program administrator and can be more or less detailed.¹⁹⁰ In Vermont, for example, mediators report the results of each mediation session (including all HAMP-related net present value calculations and other foreclosure avoidance calculations performed for the mediation)¹⁹¹ as well as whether a full or partial settlement was reached. Mediators must also provide a copy of that agreement.¹⁹² Some programs also have mediators issue a mediation certification that the lender must either present to the Court in order to proceed with the judicial foreclosure proceeding¹⁹³ or file with land records in a nonjudicial foreclosure jurisdiction.¹⁹⁴ Other

¹⁸⁶ See WASH. REV. CODE ANN. § 61.24.163(9) (West 2012); WASH. STATE DEP'T OF COMMERCE, EXPECTATIONS OF A FORECLOSURE MEDIATOR (2012), <http://www.commerce.wa.gov/Documents/FFP-Expectation-of-a-Foreclosure-Mediator.pdf>. Running these calculations is required before the mediator can issue the mediation certification the lender needs to proceed with foreclosure.

¹⁸⁷ See, e.g., CONN. GEN. STAT. § 49-31n (2012) (requiring the mediator to determine whether parties to a foreclosure proceeding will benefit from further mediation and, if so, file a report with the court describing the proceedings, any issues resolved, and any issues unresolved).

¹⁸⁸ See, e.g., WASH. REV. CODE § 61.24.163(7)(b) (2012).

¹⁸⁹ Cuyahoga County, Ohio has mediators refer homeowners to housing counseling prior to mediation. The housing counselor attempts to work out a foreclosure alternative between the lender and borrower and reports back to the mediator. The mediator can help the parties finalize any agreements reached. If a borrower fails to go to housing counseling, then the borrower's right to mediation ends and the case proceeds in court. *Foreclosure Action Coalition: Cuyahoga County "Foreclosure Time Out" Plan*, NAT'L CONSUMER LAW CTR., http://www.nclc.org/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/ohio_alt_proposal.pdf (last visited Mar. 7, 2013).

¹⁹⁰ In Maine, for example, a mediator must complete a report for each mediation. The report must indicate that the parties completed the Net Present Value Worksheet in the FDIC Loan Modification Program Guide. If the mediation did not result in the settlement or dismissal of the action, the report must include the outcomes of the Net Present Value Worksheet. As part of the report, the mediator may notify the court if, in the mediator's opinion, either party failed to negotiate in good faith. See ME. REV. STAT. tit. 14, § 6321-A(13) (2010).

¹⁹¹ VT. STAT. ANN. tit. 12, § 4634(b)(4) (2012).

¹⁹² *Id.* § 4634(b)(5).

¹⁹³ DEL. CODE ANN. tit. 10, § 5062C(i)(9) (2012).

¹⁹⁴ D.C. CODE § 42-815(d) (2012).

programs created standard report forms for mediators to complete after a mediation session. These forms identify whether an agreement was reached, whether and under what terms the homeowner is retaining or relinquishing the property, and the specifics of any loan modification or agreement regarding the deficiency.¹⁹⁵

Another responsibility sometimes placed on the mediator is to monitor the parties and assess whether they have negotiated in good faith and, if not, to suggest what sanctions to impose. This assessment of good faith occurs primarily in nonjudicial foreclosure states where there is no direct court supervision of foreclosure proceedings,¹⁹⁶ although some judicial foreclosure states also require mediators to report whether the parties mediated in good faith.¹⁹⁷ As is discussed in greater detail below, using the mediator to report on party behavior can be an effective way for a program to provide oversight but the reporting should involve objective criteria, with checklist forms provided by the program, not a subjective evaluation by the mediator of the parties' good faith participation.

There are clear benefits to having a third-party facilitator present in foreclosure mediations and settlement conferences. Simply bringing the parties together and relying on them to reach resolution on their own is unlikely to work, given the problematic nature of the relationship between loan servicers and homeowners.¹⁹⁸ Mediators can help adjust for any imbalance of power between the lender representative and the homeowner. Not all homeowners have the assistance of legal counsel and not all homeowners going to mediation have met with a housing counselor.¹⁹⁹ The mediator can help create a structure to the

¹⁹⁵ See, e.g., *Mediator Documents*, STATE OF NEV. FORECLOSURE MEDIATION PROGRAM, *supra* note 183; *Legal Practice Forms*, N.J. COURTS, <http://www.judiciary.state.nj.us/forms.htm#foreclosure> (last visited May 20, 2013); *Foreclosure Mediation Program Model Documents, Resources and Training*, SUPREME COURT OF OHIO, <http://www.sconet.state.oh.us/JCS/dispute/Resolution/foreclosure/documents.asp> (last updated Oct. 2009); *Foreclosure Fairness Program*, WASH. DEP'T OF COMMERCE, <http://www.commerce.wa.gov/site/1367/default.aspx> (last visited May 20, 2013).

¹⁹⁶ Nevada mandates foreclosure mediators to prepare and submit to the program a recommendation for sanctions on a lender or its representative who fails to attend the mediation, participate in good faith, or exchange required documents. NEV. REV. STAT. § 107.086(5) (2011). If the borrower does not appear for the mediation session, then the lender receives a certificate and can proceed with the foreclosure process. *Id.* § 107.086(6).

¹⁹⁷ See, e.g., DEL. CODE ANN. tit. 10, § 5062C(e)(2), (f) (2012); ME. REV. STAT. tit. 14, § 6321-A(12) (2010); VT. STAT. ANN. tit. 12, § 4634(b)(A)(2) (West 2012). Not all programs define good faith merely as attendance in mediation, presuming mediators will know a lack of good faith in mediation when they see it. See *infra* note 231 and accompanying text.

¹⁹⁸ Some states, like Washington, started out with a "meet and confer" program similar to California's but found that it did not do enough to change loan servicer behavior. *Washington State's Foreclosure Fairness Act: A Second Try at a Fair, Clearly Defined and Enforceable Process for Homeowners Facing Foreclosure*, MY VIEW (Wash. State Hous. Fin. Comm'n), June 2011, at 2, available at <http://www.wshfc.org/newsletter/2011.06.print.pdf>.

¹⁹⁹ See *infra* Part III.E.

negotiations so that all alternatives to foreclosure are systematically explored. A properly trained mediator can help the parties work through the borrower's financial documents and apply the loan servicer's loan modification evaluation methods. Additionally, programs that give mediators the power to report on parties' behavior send the clear message to lenders that these mediation sessions are to be taken seriously. An ADR program not just another procedural hoop through which the lender must pass but is designed to make parties assess whether foreclosure really is the best way to proceed.

3. Confidentiality

The requirement that third-party facilitators provide a detailed report on the mediation session or settlement conference is controversial because of confidentiality. Mediation is a confidential process; information shared during a foreclosure mediation that is not otherwise discoverable cannot be used in other court proceedings.²⁰⁰ Many programs explicitly state that discussion during foreclosure mediation is confidential²⁰¹ or that mediators are protected from having

²⁰⁰ While there are many visions of what a process called "mediation" looks like, all consider confidentiality to be one of mediation's core principles. See, e.g., UNIF. MEDIATION ACT § 8 (2003), available at http://www.uniformlaws.org/shared/docs/mediation/uma_final_03.pdf; AM. BAR ASS'N, PREPARING FOR MEDIATION 2 (2012), available at http://www.americanbar.org/content/dam/aba/images/dispute_resolution/Mediation_Guide_general.pdf; Lela P. Love & Joseph B. Stulberg, *Understanding Dispute Resolution Processes*, in CONDUCTING THE MEDIATOR SKILL-BUILDING TRAINING PROGRAM—INSTRUCTOR'S MANUAL (rev. ed. 1997), reprinted in CARRIE J. MENKEL-MEADOW, LELA PORTER LOVE & ANDREA KUPFER SCHNEIDER, *MEDIATION: PRACTICE, POLICY, AND ETHICS* 14–16 (2006). Most states have laws with confidentiality provisions that protect mediation communications. A few state foreclosure mediation statutes, like Washington's, have confidentiality clauses in them. See WASH. REV. CODE §§ 61.24.169(4) (2012).

²⁰¹ The foreclosure mediation programs in Connecticut, Oregon, Tuscarawas County, Ohio, and Wisconsin's Sheboygan County all state that mediation sessions are confidential. See OR. ADMIN. R. § 137-110-0410(1)(b)(ix) (2013); COURT OF COMMON PLEAS, TUSCARAWAS CNTY., OHIO, FORECLOSURE MEDIATION PROGRAM (2008), available at <http://www.co.tuscarawas.oh.us/treasurer/Resources/Final%20Foreclosure%20Brochure1.pdf>; *Foreclosure Mediation Program: Homeowner Frequently Asked Questions*, STATE OF CONN. JUDICIAL BRANCH, http://www.jud.ct.gov/foreclosure/homeowner_qs.htm#10 (last visited May 20, 2013); *Sheboygan County Foreclosure Mediation Program FAQ*, SHEBOYGAN CNTY., WISC., <http://www.sheboygancounty.com/government/departments-a-e/clerk-of-circuit-courts/foreclosure-mediation-program-faq> (last visited May 20, 2013). Nevada's foreclosure mediation program rules state:

All documents and discussions presented during the mediation shall be deemed confidential and inadmissible in any subsequent actions or proceedings, *except* in an action for judicial review . . . In that case, non-privileged evidence submitted for mediation is discoverable, with the exception of confidential information such as social security numbers, account numbers, and tax ID numbers pursuant to the redaction statute.

to testify in court,²⁰² although some make no mention of confidentiality at all. When confidentiality is mentioned, it is usually in reference to the documents exchanged in mediation and any personal financial information discussed in mediation.²⁰³ For states that have already adopted the Uniform Mediation Act (UMA), confidentiality may automatically apply to these sessions or there may be other state law regulating the confidentiality of mediation sessions.²⁰⁴

On the one hand, it is important for jurisdictions to be able to evaluate whether mediation sessions are in fact accomplishing what they promise. Because mediations and settlement conferences are private and there is no public record of the discussion, it is difficult to know if the parties and the facilitator are systematically assessing each variation on a loan modification and each non-retention alternative. Without a mediator's report, the only information available to a program administrator is the written agreement reached in mediation and what the administrator might hear anecdotally. On the other hand, placing the mediator in the position of completing a report or recommending sanctions on a party fundamentally changes the role of the mediator from neutral facilitator to evaluator.²⁰⁵ The Uniform Mediation Act prohibits mediators from making reports, assessments, evaluations, recommendations, findings, or other communications "regarding a mediation to a court, administrative agency, or other authority that may make a ruling on the dispute that is the subject of the mediation."²⁰⁶

Confidential foreclosure ADR processes raise additional concerns for self-represented homeowners. Mediation, because it is confidential, may fail to bring to light loan servicers' misconduct or fraudulent business practices, such as robo-signing, failure to provide proper notice, and failure to comply with federal requirements for considering

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²⁰² See, e.g., VT. STAT. ANN. tit. 12, § 4635(c) (2012).

²⁰³ CONN. GEN. STAT. § 49-310(b) (2009) (stating that information submitted by the mortgagor to the mediator, either orally or in writing, including financial documents, is not subject to disclosure by the judicial branch).

²⁰⁴ For states that call ADR sessions "settlement conferences," "conciliation," or "dispute resolution" sessions, instead of "mediation," as Hawaii, Indiana, and New York do, statutory mediation confidentiality rules may not apply.

²⁰⁵ Heather Scheiwe Kulp at Resources Study Innovation for Court ADR has raised this concern. See, e.g., Heather Scheiwe Kulp, *Foreclosure Mediation, Saving Homes, and Appropriate Dispute Resolution*, JUST COURT ADR (Feb. 23, 2012), <http://blog.aboutrsi.org/2012/program-management/foreclosure-mediation-saving-homes-and-appropriate-dispute-resolution>.

²⁰⁶ UNIF. MEDIATION ACT § 7(a) (2003). There are few exceptions to this prohibition, one of which is that mediators are permitted to disclose whether the mediation occurred or has terminated, whether a settlement was reached, and who attended. *Id.* § 7(b). Of the jurisdictions that have reporting requirements for mediators in their foreclosure mediation programs, only three, Ohio, Washington State, and Washington, D.C., have also adopted the UMA.

homeowners' HAMP applications. Because of the mediator's neutral role, the mediator may not be in a position to raise these problems and hold the loan servicer accountable. And, unless the borrower is exceptionally sophisticated, she or he will not know how to take action either. Another concern for self-represented homeowners is if the mediator fails to follow the prescribed mediation process, behaves inappropriately, or lacks competence. In both circumstances, if the borrower has legal counsel, then that lawyer can apply appropriate pressure on the lender representative, inform the borrower of his or her legal rights, and protect the borrower from agreeing to something that may not be in his or her best interest.²⁰⁷

Using mediation and settlement conferences as the forum for foreclosure negotiations rather than a judicial process in open court does have the potential to hide loan servicer misconduct from public view. Consumer advocates, if they had access to the contents of mediation conversations, would not have to rely on anecdotal evidence and would be in a better position to educate borrowers and advise policy makers about what lenders and loan servicers are doing. Thus, there is a tension between providing a safe environment that fosters candid conversation and allows for individualized problem-solving, and protecting consumers on a wide scale. One way in which programs can strike a balance between these two competing interests is to make the reporting responsibility of third-party facilitators known to all parties and to provide facilitators with standard forms that capture the topics discussed and objective outcomes.

E. *Legal Counsel and Housing Counselors*

One important way in which state and local governments can help borrowers prepare for, and engage in, foreclosure negotiations is to incorporate free, HUD-approved housing counseling organizations²⁰⁸ and legal assistance into their foreclosure ADR programs. To have the greatest impact, borrowers should meet with counselors and attorneys well in advance of a mediation or settlement conference. Programs can pay for housing counseling and legal assistance with funds generated by the program. Navigating the complex process of applying for a loan

²⁰⁷ The importance of legal counsel in informal processes like mediation has been noted by scholars. Not only do lawyers provide knowledge of the substantive law and legal procedure, but they can also leverage that knowledge strategically. Additionally, lawyers can empower their clients, balance power inequalities, and provide emotional support. See Stephen Landsman, *Nothing for Something? Denying Legal Assistance to Those Compelled to Participate in ADR Proceedings*, 37 FORDHAM URB. L.J. 273 (2010); Jean R. Sternlight, *Lawyerless Dispute Resolution: Rethinking a Paradigm*, 37 FORDHAM URB. L.J. 381 (2010).

²⁰⁸ See *supra* note 91 and accompanying text.

modification, let alone overcoming the challenge of communicating effectively with a loan servicer, is difficult for all homeowners. These challenges are one reason the foreclosure crisis unfolded in the first place. Housing counselors provide vital assistance to homeowners faced with foreclosure by explaining the foreclosure timeline, working with homeowners to create sustainable household budgets and reduce debt, helping assemble loan modification applications or advising on non-retention options, and negotiating with the lender's points of contact on the homeowners' behalf.²⁰⁹ Indeed, homeowners who work with a housing counselor are more likely to obtain a loan modification with larger payment reductions or find a sustainable cure for a delinquent loan.²¹⁰

Programs take one of three approaches for linking homeowners to housing counselors. One is to have lenders simply inform homeowners about the existence of housing counselors and to provide lists and contact information for local, HUD-approved counseling agencies and local, community-based resources.²¹¹ The responsibility for initiating contact with the housing counselor then rests on the homeowner. A second approach is to make meeting with a housing counselor a precondition for participating in a foreclosure ADR program.²¹² The

²⁰⁹ The Urban Institute conducted a two-year study of the impact of the National Foreclosure Mitigation Counseling program, the federally funded program, overseen by Neighborworks America, designed to increase the role of foreclosure intervention counseling in the response to the foreclosure crisis. In its 2010 report, the Urban Institute found that homeowners who worked with housing counselors were 1.7 times more likely to cure an existing foreclosure than if they had not received counseling. On average, homeowners who received counseling reduced their monthly payments by \$267 more than those homeowners who did not have counseling, and therefore, were more likely to remain current on the modified loan. NEIL MAYER ET AL., THE URBAN INST., NATIONAL FORECLOSURE MITIGATION COUNSELING PROGRAM EVALUATION: PRELIMINARY ANALYSIS OF PROGRAM EFFECTS vii-viii (2010), available at http://www.urban.org/UploadedPDF/411982_NFMC_program_evaluation.pdf.

²¹⁰ A study by the Urban Institute evaluating the impact of the National Foreclosure Mitigation Counseling Program, overseen by NeighborWorks America, found that individuals who had received NFMC counseling had their loans modified by an average of \$176 less than individuals without counseling. Furthermore, homeowners who received counseling were sixty-seven to seventy percent more likely to remain current on their mortgages after curing a serious delinquency or foreclosure than those homeowners without counseling. NEIL MAYER ET AL., THE URBAN INST., NATIONAL FORECLOSURE MITIGATION COUNSELING PROGRAM EVALUATION: FINAL REPORT ROUNDS 1 AND 2, at 106 (2011), available at <http://www.urban.org/UploadedPDF/412475-National-Foreclosure-Mitigation-Counseling-Program-Evaluation.pdf>.

²¹¹ See, e.g., CONN. GEN. STAT. § 49-311(c)(3) (2011) (requiring lenders to include in the notice of foreclosure mediation materials from the Department of Banking that describe community-based resources available to the mortgagor as well as approved housing counseling agencies).

²¹² See, e.g., S.B. 1552 § 2a(1)-(2), 76th Leg. Assemb., Reg. Sess. (Or. 2012), 2012 Or. Laws Ch. 112, at 3 (requiring homeowners to consult with a housing counselor from a HUD-approved organization before the scheduled date of the mediation and also requiring lenders to include a statement in its foreclosure notice informing the borrower of the requirement to consult with an approved housing counselor); N.M. Admin. Order No. 2009-00001, *supra* note

homeowner may be required to present a certificate verifying meeting with the housing counselor as a prerequisite to the mediation.²¹³ The third approach uses housing counselors as gatekeepers to the mediation process itself. Homeowners are either automatically scheduled to meet with a housing counselor²¹⁴ or must take the initiative to make an appointment,²¹⁵ after which the housing counselor determines whether to refer the homeowner for foreclosure mediation.

Free legal assistance for homeowners facing foreclosure is an extremely valuable resource. Most homeowners in foreclosure are self-represented²¹⁶ primarily because they are not financially able to hire a lawyer. Without legal assistance, homeowners are unlikely to be aware of their legal protections under local, state, and federal laws, let alone appropriate legal defenses to foreclosure. In addition, homeowners in judicial foreclosure states must contend with court filings and the intricacies of judicial procedure as self-represented litigants. Because of these concerns surrounding alternative dispute processes and foreclosure, some jurisdictions attach pro bono legal assistance to their foreclosure mediation programs.²¹⁷ Other programs, like the one in Cook County, provide homeowners with a free consultation with a pro bono attorney.

Other states leveraged new professional responsibility rules to encourage attorneys to provide pro bono services to homeowners in

93, § 6(B), at 4 (requiring homeowner to consult with a counselor from a HUD-certified housing counseling agency no less than twenty business days before the scheduled mediation).

²¹³ See, e.g., HAW. REV. STAT. § 667-80(c)(2)(F) (West 2012) (requiring the homeowner to produce verification of counseling by an approved housing counselor or an approved budget and credit counselor); H.B. 1374, 430th Leg. Assemb., Reg. Sess. (Md. 2012) (requiring homeowners seeking to obtain certification of participation in housing counseling as a precondition to mediation).

²¹⁴ Some courts in New York's larger jurisdictions schedule homeowners for a pre-settlement conference screening meeting at the courthouse where they meet with HUD-approved housing counselors and volunteer lawyers, if needed. See PFAU, *supra* note 148, at 7–8.

²¹⁵ See, e.g., WASH. REV. CODE §§ 61.24.160(3), 61.24.163(1) (2012) (reserving the state foreclosure mediation program only for borrowers who have been referred to mediation by a housing counselor or attorney, and also requiring housing counselors to refer homeowners to mediation based on their individual circumstances).

²¹⁶ Justin Wagner, *Assisting Distressed Homeowners to Avoid Foreclosure: An Advocate's Role in an Evolving Judicial and Policy Environment*, 17 GEO. J. ON POVERTY L. & POL'Y 423, 443–45 (2010) (citing a study by the Brennan Center for Justice that, of homeowners facing foreclosure proceedings for high-cost, non-traditional mortgages, between eighty-four and ninety-two percent proceeded without full legal representation).

²¹⁷ New York and Philadelphia make attorneys available, free of charge, to eligible homeowners. David Streitfeld, *New York Courts Vow Legal Aid in Housing*, N.Y. TIMES, Feb. 16, 2011, at B1 (“[B]y the end of the year, any homeowner in foreclosure who does not have a lawyer will be supplied one by legal aid groups or other pro bono groups.”); see also Get Legal Help, CMTY. LEGAL SERVS. OF PHILA, <http://www.clsphila.org/Content.aspx?id=115> (last visited May 20, 2013).

foreclosure ADR by permitting forms of limited representation.²¹⁸ States launched state-wide programs to train attorneys who could volunteer to help distressed homeowners in foreclosure mediation.²¹⁹ Training covers the basics of foreclosure procedure, available state and federal assistance programs, and expectations for foreclosure ADR. Homeowners going into a foreclosure ADR session and seeking legal assistance are matched with trained pro bono attorneys who can review borrowers' documents, research available options, and negotiate during the mediation session. In Maryland, attorneys who completed foreclosure prevention training also provided brief advice during foreclosure solutions workshops held around the state.

F. *Exchanging of Documents*

Two primary objectives of foreclosure ADR programs are to create open, transparent communication between the parties and provide oversight of loan servicer behavior. An essential tool for reaching these objectives is to require parties to exchange key documents prior to, or during, the mediation or settlement conference. The specific documents required may be included in the statutory language itself²²⁰ or determined by the entity in charge of administering the mediation program.²²¹ Homeowners and loan servicers can either mail the information directly to each other, submit documents to a third party²²² or they can upload the documents onto a secure, online platform.²²³

²¹⁸ See, e.g., MD. R. PROF'L CONDUCT 6.5; OHIO R. PROF'L CONDUCT 1.2(c).

²¹⁹ In fact, it was by participating in Maryland's attorney training program that I first became involved in foreclosure mediation work. I taught my students about foreclosure mediation and folded counseling at foreclosure workshops into the work of the Mediation Clinic for Families at the University of Baltimore School of Law.

²²⁰ See, e.g., HAW. REV. STAT. §§ 667-80(c) (2012).

²²¹ See, e.g., MD. CODE ANN., REAL PROP. § 7-105.1(h)(1) (West 2012) (requiring Maryland's Commissioner of Financial Regulation to determine which documents lenders must provide to the borrower prior to mediation).

²²² The third party can be either a housing counselor or court administrator, Timothy C. Evans & Moshe Jacobius, CIRCUIT COURT OF COOK CNTY., IL., MORTGAGE FORECLOSURE MEDIATION PROGRAM: PROGRESS REPORT 9 (2012), available at [http://www.cookcountycourt.org/Portals/0/Chancery%20Division/Foreclosure%20Mediation/Foreclosure%20Mediation%20Progress%20Report%20June%202012%20\(with%20Appendixes\).pdf](http://www.cookcountycourt.org/Portals/0/Chancery%20Division/Foreclosure%20Mediation/Foreclosure%20Mediation%20Progress%20Report%20June%202012%20(with%20Appendixes).pdf), the government entity in charge of administering the mediation or settlement program, HAW. REV. STAT. § 667-80(c) (2012), or sometimes the mediator, WASH. REV. CODE § 61.24.163(4) (2012)).

²²³ For example, Indiana created a secure, online portal that borrowers and lender representatives can access to upload required documents. Borrowers and lenders, as well as their attorneys and housing counselors, can create accounts through the portal and invite other parties to access the specific loan information by sharing a unique invitation code. DMM Portal, DEFAULT MITIGATION MANAGEMENT, <https://www.dclmwp.com> (last visited May 20, 2013). Other jurisdictions, like Maryland and Hawaii, created online portals to allow borrowers to submit home retention applications to their lenders. The online portals avoid the delay and risk of lost paperwork that come with mailing and faxing.

Failure to comply with the mandated document exchange should be considered a violation of applicable good faith requirements²²⁴ and subject the violator to sanctions.

Homeowners' required documents should relate to their financial status and eligibility for loan modification programs. To show their financial status, borrowers can produce proof of current and anticipated income, debts, and assets;²²⁵ tax returns for the past two years; hardship information; and a detailed budget of monthly expenses. They should provide information about the mortgage and payment history, including records or correspondence relating to the default or loan modification; verification of counseling from an approved housing counselor including the counselor's contact information; and a complete modification package for all applicable federal loan modification programs.

Homeowners should submit these documents in advance of the mediation or settlement conference to maximize efficiency. Usually, the person physically present at the mediation representing the lender is a lawyer hired by the loan servicer and the person with decision-making authority participates in the mediation by phone. The attorney in the room may not know how to extract the right information from the financial documents, run a net present value analysis, or evaluate a borrower's loan modification package and the loan servicer on the phone cannot see the documents that the borrower brings to the mediation. By having the borrower submit her documents before the mediation, the loan servicer can make the necessary assessment of whether it is best to pursue the foreclosure or whether an alternative, such as a modification under HAMP or a non-retention option, is more appropriate. With this assessment complete, the scope of the settlement negotiation can be clarified for all parties.

Many programs require documents from servicers and lenders that are necessary to determine whether there is legal standing to pursue foreclosure and, if so, whether a proper assessment has been completed to determine if foreclosure really is the proper remedy. To prove proper legal standing, loan servicers may have to produce a copy of the promissory note signed by the mortgagor that also includes endorsements, amendments, or riders; a copy of the mortgage document evidencing the lender's legal interest in the property and the right to foreclose; and payment history and correspondence confirming the loan's default status. Loan servicers may also need to provide a

²²⁴ See, e.g., WASH. REV. CODE § 61.24.163(10)(a) (2012). But, not all programs include a good faith requirement.

²²⁵ Proof may be in the form of copies of pay stubs, W-2 forms, social security or disability income, retirement income, child support income, or any other income relevant to the homeowner's ability repay the mortgage. See, e.g., HAW. REV. STAT. § 667-80(c)(2)(a) (2012).

sufficiently detailed explanation of why previous requests for loan modification, forbearance, or other foreclosure alternatives were denied; an itemized list of the best estimate of arrearages, fees, and outstanding charges; a recent appraisal of the property; and borrower-related and mortgage-related input used in any net present value analysis. Some programs also require loan servicers to produce any provisions in the pooling and servicing agreement that prohibit the loan servicer from modifying the loan or forgiving a deficiency upon short sale, along with proof that the servicer has attempted to obtain a waiver of those provisions.²²⁶ This last piece of information is extremely important for understanding what obligations the loan servicer has to the investor trust and whether these obligations can be waived in certain situations.²²⁷

A document exchange requirement proves efficient and opens lines of communication early. Parties have the essential information up front, are spared the need to request and then wait for information, and can come to the mediation sessions prepared.²²⁸ Compelling parties to provide specific pieces of information, such as the pooling and servicing agreement governing the loan or the homeowner's financial statements, makes the parties' respective positions transparent. The loan servicer can begin assessing the borrower for a loan modification or other retention plan before the mediation begins. The borrower can know, before walking into a negotiation, whether keeping the house is an option on the negotiation table or whether to focus on non-retention foreclosure alternatives, like a short sale or a deed in lieu of foreclosure.²²⁹ Furthermore, requiring loan servicers to show their

²²⁶ See, e.g., HAW. REV. STAT. § 667-80(c)(1) (2012); VT. STAT. ANN. tit. 12, § 4633(a)(2)–(3) (2012); WASH. REV. CODE § 61.24.163(5) (2012).

²²⁷ In one foreclosure mediation I observed, the loan servicer was unable to provide the homeowner with a loan modification because the pooling and servicing agreement between the loan servicer and the investor trust prohibited the mortgage interest from dropping below 10.5%. HAMP does not, and cannot, force loan servicers to break the terms of their servicing contract in order to modify a loan; however, it would have been interesting to see whether the loan servicer might have appealed successfully to the investor trust in seeking a waiver of this provision, proof of which is required by Hawaii and Washington's programs.

²²⁸ Pre-mediation exchange of information has proved a challenge for Maine's foreclosure mediation program. Parties arrive at the first mediation unprepared to negotiate because: 1) the homeowner has not provided the lender with necessary documents; 2) the financial information provided by the homeowner was incomplete or not current; 3) the lender did not receive information the homeowner reportedly sent; 4) the lender requests additional information from the homeowner, and 5) the lender has not reviewed the homeowner's information, despite timely receipt. When this happens, frequently the mediators set a date for an additional mediation session so that the parties can exchange the identified, necessary information and return to the second mediation session prepared to work on an agreement. DIANE E. KENTY, FORECLOSURE DIVERSION PROGRAM: REPORT TO THE JOINT STANDING COMMITTEE ON INSURANCE AND FINANCIAL SERVICES 4–5 (2012), available at http://www.courts.state.me.us/reports_pubs/reports/pdf/fdp_ar_2011.pdf.

²²⁹ Nevada also requires both the lender and the borrower to submit to the mediator, prior

analysis for a loan modification forces them out of automation, the way of doing business that contributed to the foreclosure crisis in the first place. To show their analysis, they must in fact compare the costs and benefits of foreclosure and determine which outcome, foreclosure or some alternative, will maximize recovery for the investors with mortgage backed securities. Finally, as will be discussed in greater detail in the next section, programs can ensure party compliance with document exchange by issuing sanctions. For the loan servicer or lender, the foreclosure may be dismissed in a judicial foreclosure jurisdiction or they may not be granted the mediation certification necessary for moving forward with foreclosure. For the borrower, the opportunity to participate in the ADR program may be lost.

G. *Judicial Oversight and Sanctions*

State and local governments are more likely to reach their objectives if foreclosure ADR program rules are enforced. Almost all existing foreclosure ADR programs built sanctionable offenses and corresponding penalties into the program rules. As discussed above,²³⁰ many programs rely upon mediators to report when a party fails to comply with rules. Thus, jurisdictions that enumerate each sanctionable offense are more likely to have accurate reporting than those jurisdictions that have a blanket good faith requirement.²³¹ Upon receiving reports of misconduct, courts in both judicial and nonjudicial foreclosure jurisdictions should consistently enforce program rules by ordering sanctions against offending parties.

Common sanctionable offenses for both borrowers and lenders exist to compel parties to come to the negotiation table prepared to work out viable alternatives to foreclosure. For example, borrowers and lenders that fail to appear at the mediation session, fail to cooperate and participate in it, or fail to exchange required documents before deadline are subject to sanctions.²³² Additionally, failure to have someone with

to the mediation session, a confidential, non-binding settlement proposal. NEV. FORECLOSURE MEDIATION R. 11.9.

²³⁰ See *supra* Part III.D.

²³¹ See *supra* note 196–197 and accompanying text. Delaware, Vermont, and Maine require mediators to report lack of good faith but do not provide objective criteria for what that might look like. DEL. CODE ANN. tit. 10, § 5062C(e)(2), (f) (2012); ME. REV. STAT. tit. 14, § 6321-A(12) (2010); VT. STAT. ANN. tit. 12, § 4634(b)(A)(2) (2012). For more on good faith requirement in foreclosure mediation, see MELANCA CLARK & DANIEL OLMOS, U.S. DEP'T OF JUSTICE, FORECLOSURE MEDIATION: EMERGING RESEARCH AND EVALUATION PRACTICES (2011), available at <http://www.justice.gov/atj/foreclosure-mediation.pdf>; GEOFF WALSH, NAT'L CONSUMER LAW CTR., RECENT DEVELOPMENTS IN FORECLOSURE MEDIATION (2011).

²³² See, e.g., D.C. CODE § 42-815.02(e) (2012). Failures to pay mediation fees can also generate sanctions, but those sanctions target the sustainability of the program rather than

authority to make decisions about the loan present at the mediation session, or connected via teleconference, exposes a party to sanctions.²³³ Both parties can be sanctioned for failing to take the negotiation seriously, but some sanctions only target loan servicer behavior; for example, proceeding with foreclosure even though it is not in investors' best interest.²³⁴

Borrowers and lenders that commit sanctionable offenses face a range of penalties. Borrowers may be fined or may lose their opportunity to mediate. Any stay on the foreclosure proceeding can be lifted to enable a foreclosure sale to proceed.²³⁵ Lenders who violate program rules face case dismissals in judicial foreclosure states and, in nonjudicial states, either a stay of foreclosure proceedings or prohibition on recording foreclosure sale notices.²³⁶ Dismissals and stays do not prevent the lender from initiating foreclosure in the future. Additionally, delaying foreclosure while a borrower is in default ultimately harms the borrower. The longer the loan delinquency remains uncured, the more mortgage penalties and late fees accrue and the harder it becomes for a borrower to workout foreclosure alternatives.²³⁷ Thus, financial penalties against lenders are effective and do not carry unintended, negative consequence for borrowers. In addition, financial penalties can include fines paid to the mediation program administrator or directly to the borrower.²³⁸

impressing upon parties the importance of the opportunity to negotiate.

²³³ See, e.g., ME. REV. STAT. tit. 14, § 6321-A(11) (2010) (requiring the mortgagee who has the authority to agree to a proposed settlement, loan modification, or dismissal of the action, to appear in person or participate by telephone with a representative present, and also requiring the presence of the borrower, counsel for the lender, and counsel for the borrower, if represented); WASH. REV. CODE § 61.24.163(10)(c) (2011) (considering it a violation of the duty of good faith to fail to designate representatives with adequate authority to settle, compromise, or otherwise reach resolution in mediation).

²³⁴ For example, Washington gives borrowers a right to enjoin, or set aside, a foreclosure proceeding if the net present value of a proposed modified loan exceeds the anticipated net recovery at a foreclosure sale. WASH. REV. CODE § 61.24.163(14)(c) (2012). A loan servicer in Washington also violates its duty to mediate in good faith by asking a borrower to waive any potential future claims connected with the mortgage as a precondition to the lender agreeing to a modification. See WASH. STATE DEP'T OF COMMERCE, FORECLOSURE MEDIATION SCHEDULING NOTICE, <http://www.commerce.wa.gov/Documents/FFP-Foreclosure-Mediation-Scheduling-Form.doc>.

²³⁵ HAW. REV. STAT. § 667-82(b) (2012) (authorizing sanctions against an owner-occupant for unjustified noncompliance with the program that include removing the stay of the foreclosure and maximum \$1500 payment to the mortgagee).

²³⁶ See, e.g., PROVIDENCE, R.I., CODE OF ORDINANCES § 13-217. Washington makes a lender's failure to comply with the foreclosure mediation statute a defense to foreclosure. WASH. REV. CODE § 61.24.163(14)(a) (2012).

²³⁷ MORTG. BANKERS ASS'N, *supra* note 26, at 4; Letter from Geoff Walsh, Staff Attorney, Consumer Law Center, to Supreme Court of Illinois Mortgage Foreclosure Committee (May 23, 2012) (on file with author) [hereinafter Walsh Letter].

²³⁸ See, e.g., D.C. CODE § 42-815.02(e)(2)(A) (2012); HAW. REV. STAT. § 667-82(b)(1) (2012); DEL. CODE ANN. tit. 10, § 5062C(k) (2012) (preventing lenders from claiming attorneys' fees if

Courts in judicial and nonjudicial jurisdictions oversee foreclosure mediation and settlement programs, ordering sanctions against parties for violating rules. Judicial oversight may be triggered by a mediator's report or a parties' petition for sanctions.²³⁹ In Nevada, even though courts have the power to impose sanctions on parties,²⁴⁰ sanctions were at the discretion of local courts until the Nevada Supreme Court interpreted judicial oversight of foreclosure mediation programs as a statutory mandate.²⁴¹ The Nevada Supreme Court now issues a report detailing lender compliance with the program's statutory requirements.²⁴² Courts in Connecticut and Maine, both judicial foreclosure states, also have judicial guidelines to sanction lenders and loan services for failure to comply with program rules.²⁴³ Maine's courts, for example, have required lenders to reimburse homeowners' attorney's fees and prohibited lenders from charging the homeowner for accrued interest and fees while the foreclosure action remains in mediation.²⁴⁴

Florida's statewide managed mediation program demonstrates what happens when there is inadequate or inconsistent judicial oversight. The statewide program contained provisions for a local court to impose sanctions against parties present without the authority to

the lender does not appear at mediation prepared or fails to comply with any other program rule); S.B. 1552 § 4a(5), 76th Leg. Assemb., Reg. Sess. (Or. 2012), 2012 Or. Laws Ch. 112, at 4 (2012) (requiring lenders to pay the borrower for actual damages incurred from the lender's failure to comply with the statutorily mandated provisions).

²³⁹ For example, Maryland gives borrowers three years from the date of the order ratifying sale to bring an action against a lender for failing to comply with the statutorily mandated foreclosure rules. MD. CODE ANN., REAL PROP. § 7-105.1(q) (West 2012). In Nevada, if either party does not fulfill the obligations of a temporary agreement, the aggrieved party may file a petition for judicial review. NEV. FORECLOSURE MEDIATION R. 16.3.

²⁴⁰ NEV. FORECLOSURE MEDIATION R. 21.

²⁴¹ *Pasillas v. HSBC Bank USA*, 255 P.3d 1281, 1285–87 (Nev. 2011) (holding that the district courts must sanction parties that violate requirements of the foreclosure mediation statute and that courts may not certify completion and permit continuation of foreclosure, but that in determining the sanctions to be imposed, district courts should consider, among other things, “whether the violations were intentional, the amount of prejudice to the nonviolating party, and the violating party’s willingness to mitigate any harm by continuing meaningful negotiation”); *see also* *Leyva v. Nat’l Default Serving Corp.*, 255 P.3d 1275, 1281 (Nev. 2011) (finding that failure to bring required documents to mediation is a sanctionable offense and that district courts should determine and order appropriate sanctions).

²⁴² *See, e.g.*, FORECLOSURE MEDIATION PROGRAM, SUPREME COURT OF NEV., FORECLOSURE MEDIATION PROGRAM BENEFICIARY COMPLIANCE OUTCOMES (2012), <http://www.nevadajudiciary.us/index.php/viewdocumentsandforms/func-startdown/8318> (detailing the extent to which the six primary loan servicers in Nevada (Bank of America, Wells Fargo, JP Morgan Chase, Ally/GMAC, US Bank, CitiGroup) and others complied with statutory requirements of the state foreclosure mediation program, such as attendance at mediation, production of required documents, authority to negotiate, and good faith participation).

²⁴³ *See, e.g.*, STATE OF CONN. SUPERIOR COURT, UNIFORM FORECLOSURE MEDIATION STANDING ORDERS (2010), http://www.jud.ct.gov/external/super/Standorders/Civil/FMP_010510.pdf.

²⁴⁴ KENTY, *supra* note 228, at 7.

settle cases, exchange documents, or otherwise comply with program rules;²⁴⁵ however, lack of consistency in judicial oversight across all circuit courts resulted in the Florida supreme court's decision to terminate the program altogether.²⁴⁶

Sanctioning violating parties demonstrates the importance of the program. Judicial oversight only has to occur a few times to make an example of unacceptable loan servicer or borrower behavior and send a clear message that compliance will be taken seriously.²⁴⁷ Likewise, a lack of judicial enforcement of program rules through authorized sanctions communicates to parties that mediation and settlement conferences need not be taken seriously, ultimately undermining the point of these programs in the first place.

H. *Program Costs and Funding*

Cost and funding of ADR foreclosure programs are extremely important in determining whether foreclosure ADR programs can become permanent fixtures in the foreclosure landscape. Programs that are self-sustaining or that even generate additional revenue for the state are far more likely to endure than those paid for by grants or state budgets already stretched-thin. Another important consideration is who, between the loan servicer and the borrower, ultimately bears the cost of participating in a foreclosure ADR process. Programs that require both loan servicers and borrowers to pay a fee ensure that both parties are invested in the negotiation process; however, it is important to place restrictions on the ability of loan servicers to shift the costs of an alternative process to an already financially distressed borrower.

The cost of a program depends on variety of factors, such as the volume of cases, the number of mediation sessions held in each case, whether support services like housing counseling and legal assistance are included,²⁴⁸ and how much mediators are paid.²⁴⁹ Additionally, pre-

²⁴⁵ Fla. Guidance Concerning Managed Mediation Programs, *supra* note 110, at 3, 7, A8-A12.

²⁴⁶ The Assessment Workgroup for the Managed Mediation Program for Residential Mortgage Foreclosure Cases reported that public comments demonstrated that servicers widely resisted providing their representatives at mediation full authority and refused to consider more than a narrow range of foreclosure alternatives of little value to borrower. Further, servicers had financial incentives not to settle and to keep foreclosure cases in limbo to avoid the expenses of home ownership. A sample of Eleventh Circuit foreclosure illustrated that 78.5% of the cases remained open up to two years after failing to settle in mediation. Palmer Letter, *supra* note 108, at 4. The Assessment Workgroup further recommended that the Court establish a separate workgroup to explore sanctions for noncompliance. *Id.* at 2.

²⁴⁷ Walsh Letter, *supra* note 237.

²⁴⁸ For example, Maryland pays for housing counselors out of a specially designated Housing Counseling and Foreclosure Mediation Fund. MD. CODE ANN., HOUS. & CMTY. DEV. § 4-507(c)(4) (West 2010).

mediation screening overseen by program administrators impacts the overall cost of a program.

Jurisdictions across the country use inventive approaches to pay for their foreclosure mediation programs. Some rely on existing salaried personnel and volunteers.²⁵⁰ Others use direct²⁵¹ or indirect government funding.²⁵² An increasing number of foreclosure mediation programs are self-supporting. In these programs, either the lender²⁵³ or the borrower,²⁵⁴ or sometimes both, bears the cost of the mediation through filing surcharges, mediation participation fees, and penalties for failure to comply with program requirements.²⁵⁵ The collected fees and penalties go into a separate operating fund to pay for mediators,

²⁴⁹ Having resources to pay for skilled, trained mediators is crucial. The foreclosure mediation program in Washington, D.C., has been underfunded and unable to obtain qualified mediators. The \$300 per case flat fee per mediation is not enough to attract good mediators, especially if the time spent in mediation is seven to eight hours. DEP'T OF INS., SEC. & BANKING, COUNCIL OF D.C., PERFORMANCE OVERSIGHT QUESTIONS 18 (2012), http://www.dccouncil.us/files/user_uploads/budget_responses/fy11_12_agencyperformance_disb_responses.pdf.

²⁵⁰ Both Philadelphia and Cook County, Illinois, use both volunteers and existing court personnel. See THE REINVESTMENT FUND, *supra* note 162; see also EVANS & JACOBUS, *supra* note 131, at 5–6.

²⁵¹ New York's Division of Housing and Community Renewal provides funding for housing counselors, attorneys, and court programs; its budget was increased by \$25 million for 2010. In Cook County, Illinois, the Board of Commissioners designated \$3.5 million for its program. Iowa's Attorney General gave Iowa Mediation Services \$4500 won in a fraud settlement against Ameriquet. Iowa's program received an additional \$1.5 million in federal stimulus money but is currently seeking alternative funds to continue the program. Kentucky had a grant from the Annie E. Casey Foundation for its mediation program in Jefferson County as well as state and federal grants. HEATHER SCHEIWE KULP, RESOLUTION SYS. INST., FORECLOSURE DISPUTE RESOLUTION PROGRAM MODELS STATE-BY-STATE 48, 59, 67, 101 (2012), *available at* http://aboutrsi.org/pfimages/ForeclosureMediationProgramModels_September2012.pdf.

²⁵² For example, Connecticut's program is funded by the State Banking Fund, which is funded by bank and credit union assessments; securities registration; and registration, application, license, and examination fees for investment brokers and dealers. Thus, entities participating in the banking industry pay for the foreclosure mediation program rather than Connecticut's individual tax payers. 2008 Conn. Acts, Public Act No. 08-176 (Reg. Sess.); KEVIN P. JOHNSTON & ROBERT G. JAEKLE, CONN. AUDITORS OF PUB. ACCOUNTS, AUDITOR'S REPORT: DEPARTMENT OF BANKING FOR THE FISCAL YEARS ENDED JUNE 30, 2003 AND 2004 2–3 (2005), *available at* http://www.cga.ct.gov/apa/reports/Banking,%20Department%20of_2005_0608_FY2003,2004.pdf.

²⁵³ For example, in Delaware, foreclosure mediation is free for borrowers, but lenders must pay a \$500 fee. DEL. CODE ANN. tit. 10, § 5062C(e)(3), (i)(8), (q) (2012); Del. Admin. Directive No. 2012-2, *supra* note 170, § 13.1, at 17.

²⁵⁴ In the District of Columbia, borrowers pay a fee for mediation but not lenders. Borrowers who elect to participate in mediation must pay \$50. D.C. CODE § 42-815.02(d)(1) (2012).

²⁵⁵ Lenders in the District of Columbia pay \$300 fee for filing a Notice of Default, and, if a borrower requests mediation, they are potentially subject to a \$500 civil penalty for failing to attend the mediation, to provide the documents required for the mediation, or to participate in good faith. Lenders are further subject to a \$1000 civil penalty for breaching the terms of a settlement agreement reached through mediation. D.C. CODE § 42-815.02(e)(2)(A)(i)–(iii), (e)(4)(A)(i)–(ii), (f).

administrative costs, and operating expenses.²⁵⁶ Surplus in the operating fund can be distributed to housing counselors and non-profit agencies that assist with the program.²⁵⁷

Some programs actually generate additional revenue for the state. In Nevada and Washington, both of which are nonjudicial foreclosure states that created foreclosure mediation programs through legislative statute, mediators are paid directly by the borrower and lender.²⁵⁸ However, when lenders file notices of default they must pay state fees, which are collected and redistributed. In Nevada, recording a notice of default and an election to sell costs the lender \$200, of which \$45 goes into the Account for Foreclosure Mediation, \$5 goes into an account to provide legal services for the indigent, and the remaining \$150 is deposited into the State General Fund. According to the National Consumer Law Center, in only one year after it was implemented, the \$200 notice surcharge generated between six and eight million dollars, which was used to reduce the Nevada's deficit.²⁵⁹ Washington takes a slightly different approach and channels its surplus funds to homeowner assistance programs rather than into the general revenue fund.²⁶⁰ Generating revenue from lenders and diverting that revenue into state coffers is a creative way to fund consumer protection and legal services programs.

However, while many of these costs appear to be paid by the lender, it is important to note that, in most jurisdictions, lenders are

²⁵⁶ See, e.g., Del. Admin. Directive No. 2012-2, *supra* note 170, § 13.7, at 17.

²⁵⁷ DEL. CODE ANN. tit. 10, § 5062C(q) (2012). Compare this with the Washington, D.C., program, which prohibits reverting monies from the Foreclosure Mediation Fund for general use by the District. D.C. CODE § 42-815.03 (2011).

²⁵⁸ Each party pays the mediator \$200 per session. WASH. REV. CODE § 61.24.163(17) (2012); NEV. FORECLOSURE MEDIATION R. 5(1); WASH. STATE DEP'T OF COMMERCE, *supra* note 186; *Washington Foreclosure Mediation Program*, WASH. STATE DEP'T OF FIN. INST., <http://www.dfi.wa.gov/consumers/homeownership/foreclosure-mediation.htm#.UZvZNCopnNM> (last visited Apr. 4, 2013).

²⁵⁹ See WALSH, *supra* note 38, at 35.

²⁶⁰ Washington's Foreclosure Fairness Act created a "foreclosure fairness account" into which lenders must pay \$250 for each property issued a notice of default. Engrossed Substitute H.B. 2614 §§ 8(2), 12, 62d Leg., Reg. Sess. (Wash. 2012) (codified at WASH. REV. CODE §§ 61.24.172, .174(2) (2012)). Lenders that are FDIC insured and have issued fewer than 250 default notices in the preceding year are exempt from this fee. *Id.* § 8(5) (codified at WASH. REV. CODE § 61.24.174(5)). Expenditures from the account are made as follows: up to thirteen percent goes to the state Commerce Department for implementation of the Foreclosure Fairness Act, which includes the foreclosure mediation program; no less than seventy-six percent must be used for housing counseling for borrowers; up to six percent is to be used by the consumer protection division; up to two percent goes to the office of civil legal aid to provide homeowners with legal representation; and up to three percent goes to the Department of Financial Institutions for homeowner pre-purchase and post-purchase outreach and education programs. *Id.* § 12 (codified at WASH. REV. CODE § 61.24.172). Monies given to civil legal aid out of the foreclosure fairness account must be used to supplement, not supplant, federal, state, and local dollars received by the state's civil legal aid. *Id.* § 12(3) (codified at WASH. REV. CODE § 61.24.172(3)).

permitted to shift foreclosure-related costs to the borrower by including those costs in the total amount the borrower owes. The lender can recoup those foreclosure-related costs from the proceeds of the sale of the house or include them in a deficiency judgment that attaches to the borrower. These foreclosure-related costs include the cost of participating in mediation. Therefore, even though a program may require a lender to pay for the mediation, if the mediation does not result in an agreement that would permit the borrower to stay in the home, then the borrower ultimately pays the costs when they are subtracted from the proceeds of the foreclosure sale or added to the deficiency. Vermont is one of the few states to take affirmative steps to prevent this fee-shifting from lender to borrower in situations where the foreclosure sale results in a deficiency.²⁶¹

CONCLUSION

As existing foreclosure ADR programs continue to operate and as new ones emerge, a crucial next step for foreclosure ADR programs is a systematic evaluation of every program according to the same metrics. Although a few programs have collected data, meaningful comparison across programs remains difficult.²⁶² First, these programs are fundamentally different, with varying objectives, structures,

²⁶¹ VT. STAT. ANN. tit. 12, § 4637(c) (2012) ("If the foreclosure action results in a sale with a surplus, the mortgagee may recover the full cost of mediation to the extent of the surplus. Otherwise, the mortgagee may not shift to the mortgagor the costs of the mortgagee's or the servicing agent's attorney's fees or travel costs related to mediation but may shift up to one-half of the costs of the mediator."); *see also* D.C. CODE § 42-815.02(f) (2012) (prohibiting lenders from recovering the \$300 notice of default filing fee if there is a deficiency upon the sale of the foreclosed property).

²⁶² Compare, for example, programs in Philadelphia and Nevada. Since Philadelphia's diversion program began in 2008, seventy percent of all eligible households participated in foreclosure conciliation conferences. REG'L HOUS. LEGAL SERVS., NO PLACE LIKE HOME: PHILADELPHIA'S APPROACH TO FORECLOSURE PREVENTION 8 (2011), *available at* http://rhls.org/wp-content/uploads/NoPlaceLikeHome_RHLS.pdf. Of those who participated between 2008 and 2011, twenty percent ended in agreement, two percent ended in bankruptcy, three percent ended in no agreement and twenty-two percent were still pending. HEATHER SCHEIWE KULP, RESOLUTION SYSTEMS INSTITUTE, FORECLOSURE MEDIATION AND MITIGATION PROGRAM MODELS 34-35 (2011), *available at* http://courtadr.org/files/ForeclosureMediationProgramModels_May2011.pdf.

Meanwhile, Nevada's foreclosure mediation program, from September 2009 through December 2011, held 15,274 mediations. Forty percent of those cases resulted in an agreement to a foreclosure alternative: twenty-six percent resulted in an agreement that allowed the homeowner to remain in the home, and fourteen percent resulted in a non-retention agreement that allowed the homeowner to vacate the home without a foreclosure proceeding. *See* VERISE V. CAMPBELL, STATE OF NEVADA FORECLOSURE MEDIATION PROGRAM 5 (2012), *available at* <http://www.philadelphiafed.org/community-development/events/2012/reinventing-older-communities/resources/campbell-051012-0830.pdf> (presenting historical foreclosure outcome statistics).

jurisdictional capabilities and local needs. Second, for those programs that are sufficiently similar to lend themselves to theoretical comparison, data collected often are compiled using different metrics.²⁶³ To assist programs with assessment, the Access to Justice Commission at the U.S. Department of Justice convened a working group to develop suggestions for how programs should gather data for evaluation purposes.²⁶⁴ The working group's suggestions include tracking important program characteristics. However, to compare outcomes, variations in local housing markets and local economies (e.g., unemployment or underwater properties) need to be controlled for because they impact whether a foreclosure is avoidable.

Until a thorough evaluation of these programs has been completed and it is possible to connect a program's outcomes to its structure and local economy, it seems premature to unequivocally declare one program's model as superior. In addition, because the local economy is such an important variable to consider when constructing a foreclosure ADR program, jurisdictions should be given requisite flexibility to design programs that best respond to local needs. It might also be that, for jurisdictions that had the greatest housing booms and now see

²⁶³ Compare foreclosure mediation and settlement programs in Cook County, Illinois, and New Jersey. While Cook Co. tracked settlement rates and outcomes, New Jersey only tracked settlement rates, making it impossible to know to what the parties agreed. EVANS & JACOBUS, *supra* note 131, at 23 (providing statistics from the program's first year that show that, of the 627 mediations conducted, thirty-four percent of homeowners remained in their homes with permanent loan modifications, thirty percent negotiated alternative agreements with the lender, and thirty-six percent came to no agreement and foreclosure proceeded along the traditional litigation track); cf. N.J. DEP'T OF COMMUNITY AFFAIRS, DEPARTMENT RESPONSE TO THE OFFICE OF LEGISLATIVE SERVICES ANALYSIS OF THE PROPOSED BUDGET FOR FY 2011-2012, at 17 (reporting that between January 2009 and January 2011 5300 cases completed mediation with twenty-six percent resulting in permanent settlement, twenty-three percent receiving provisional settlement, and fifty percent ending in no settlement).

Connecticut and Maine have also collected detailed records on the terms of the mediated agreements. KENTY, *supra* note 228, at 4-5 (explaining that foreclosure was avoided in at least twenty-eight percent of cases participating in the program, and that, for the cases in which an agreement was reached in mediation and the lender subsequently dismissed the foreclosure proceeding, fifty-nine percent of cases resulted in an agreement to modify the loan, in four percent of cases the lender agreed to reinstate the loan, and in one percent of cases the parties agreed to a repayment/forbearance plan; parties also agreed to a range of non-retention agreements: five percent agreed to a short sale, 1.7% to a deed in lieu of foreclosure); STATE OF CONN. JUDICIAL BRANCH, FORECLOSURE MEDIATION PROGRAM RESULTS (2012), http://www.jud.ct.gov/statistics/FMP/FMP_pie.pdf (showing that between July 1, 2008, and December 31, 2011, 12,805 cases completed mediation through its Foreclosure Mediation Program and, of those cases, sixty-seven percent resulted in the borrower staying in the home (fifty-five percent loan modification, five percent reinstatement of the loan, seven percent forbearance/repayment plan), eighteen percent were not settled, and fifteen percent resulted in the borrower moving from the home (this percentage includes agreements for a sale, a short sale, a deed in lieu of foreclosure, or an extension of the law day or sale date)).

²⁶⁴ The working group's first report, issued in December 2011, presents best practices for research and evaluation of foreclosure mediation programs. See CLARK & OLMOS, *supra* note 231, at 9-19.

homeowners saddled with underwater mortgages, policy measures other than, or in addition to, mediation will be required for economic stabilization.²⁶⁵

Nevertheless, foreclosure ADR programs developed by state and local governments are a creative solution to problems that lie at the heart of the foreclosure crisis. By introducing facilitated negotiation as a compulsory step in foreclosure proceedings, these programs reconstruct important aspects of the borrower-lender relationship lost by securitization. Specifically, they establish clear lines of communication and require the third-party loan servicer to behave as a traditional lender might, assessing whether foreclosure in fact makes the most financial sense for investors or whether an alternative might yield a greater return on the investment.

Since securitization has become a fixture in the residential mortgage landscape, states should incorporate foreclosure ADR programs as a permanent part of their residential foreclosure procedures.²⁶⁶ State legislatures in both judicial and nonjudicial jurisdictions have the power to create foreclosure ADR programs that pay for themselves and that even generate revenue for government coffers. Programs can maximize the probability that a delinquent loan will be cured if they introduce the opportunity to negotiate early in the process and also create a finite negotiation timeframe during which the foreclosure cannot move forward. Programs that enroll homeowners automatically, rather than relying on homeowner initiative to self-enroll, are more likely to reach those homeowners in greatest need of assistance. Negotiations facilitated by a trained, neutral third party ensure that the problem-solving process is structured, balanced, and well-informed. Folding in housing counseling and legal assistance to educate homeowners further empowers and protects homeowners during negotiations. Programs that demand an exchange of documents, similar to a pre-settlement discovery that parties do not have to affirmatively request, builds efficiency and transparency into the negotiation process and also guarantees that the loan servicer has proper legal standing to foreclose. Finally, enumerating sanctionable offenses

²⁶⁵ See, e.g., Robert C. Hockett, *Paying Paul and Robbing No One: An Eminent Domain Solution for Underwater Mortgage Debt That Can Benefit Literally Everyone* (Cornell Legal Studies, Research Paper, No. 12-64, 2012), available at <http://ssrn.com/abstract=2173358>; *Morning Edition: County Considers Eminent Domain as a Foreclosure Fix*, National Public Radio (July 13, 2012), <http://www.npr.org/2012/07/13/156683302/county-considers-eminent-domain-as-foreclosure-fix>.

²⁶⁶ The Uniform Nonjudicial Foreclosure Act, adopted by the National Conference of Commissioners on Uniform State Laws in 2002, should be revised to include mandatory communications between loan servicers and borrowers prior to foreclosure sale. UNIF. NONJUDICIAL FORECLOSURE ACT (2002), available at http://www.uniformlaws.org/shared/docs/nonjudicial%20foreclosure/nonjudicial_foreclosure_final_02.pdf.

and corresponding penalties gives parties recourse to request judicial oversight and helps enforce program rules.

Foreclosure ADR programs are unprecedented for a variety of reasons. While this article takes a first step in providing a comprehensive analysis of existing programs' key components, further study of their legal implications is warranted. For instance, these programs raise questions about the specificity with which some ADR programs regulate loan servicers' behavior. Although there is nothing new about ordering parties in a legal dispute to settlement conferences or mediation, it is unusual to prescribe the content of negotiations and then require one of the parties to justify its decision-making. This micromanaging of loan servicer conduct by many ADR programs reveals a deep mistrust and lack of deference to loan servicers on the part of state and local governments. In a sense, when it comes to making decisions about foreclosure, governments are overriding loan servicers' private business judgment and replacing it with one that in their estimation better serves the public's interest.

An additional question these programs raise is how to ensure ADR processes are appropriately used as a vehicle for regulating an industry and protecting consumers. ADR processes like mediation and conciliation are designed for parties that have autonomy and equal bargaining power. But homeowners in foreclosure ADR come to the negotiation table on unequal footing because, assuming there are no legal defenses to foreclosure, homeowners have no real power over whether their loan can be modified. Even the loan servicer's power to modify loans is restricted by the servicing agreements, which are imposed on homeowners' loans long after the loan is granted and without homeowner knowledge or consent. An additional defining feature of ADR processes is that they come covered with a blanket of confidentiality that can be removed only in exceptional circumstances. If the goal of lawmakers is to police loan servicers and protect consumers from loan servicer misconduct, then they need to be aware not only of ADR processes' potential benefits but also of their limitations. As policymakers continue to rely on the ADR process to address the foreclosure crisis, they must consider how to answer these questions.

