

Update on Loan Modification Litigation

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INTRODUCTION

Loan modification litigation is part of the current wave in consumer finance litigation. With the near collapse of the residential real estate market in 2008, and lingering fallout at least through 2010,¹ origination-based lawsuits against loan originators alleging predatory lending have slowed dramatically. Many of the major players in subprime lending have ceased to exist, and even more of the smaller players have disappeared.² With the originators gone or otherwise deemed judgment proof, borrowers' attorneys are now advancing new theories to defend against the dramatic uptick in foreclosures.³ As noted in this survey, the plaintiffs' bar has concentrated much of its efforts against loan servicers who, for the most part, are immune from direct liability for the origination practices of others. While servicers may face foreclosure defenses or affirmative claims based on the Truth in Lending Act ("TILA")⁴ or the Real Estate Settlement Procedures Act ("RESPA")⁵ or the like,⁶ borrowers have also begun filing claims under a variety of new theories centered on the idea that the borrower somehow has a right to

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1. See, e.g., Alvin C. Harrell, *The Great Credit Contraction: Who, What, When, Where and Why*, 26 GA. ST. U. L. REV. 1209 (2010); Kathleen E. Keest, *Consumer Financial Services Law and Policy: 1968–20?? In the Thick of the Battlefield for America's Economic Soul*, 26 GA. ST. U. L. REV. 1087 (2010); Donald C. Lampe, Fred H. Miller & Alvin C. Harrell, *Introduction to the 2009 Annual Survey of Consumer Financial Services Law*, 64 BUS. LAW. 465 (2009).

2. In effect, the mortgage markets have been nationalized, as private sources of mortgage credit have dried up. See, e.g., Harrell, *supra* note 1, at 1209–10, 1238–48.

3. See generally Martin C. Bryce, Jr., *Foreclosure Developments, Mortgage Fraud, Counterclaims and Defenses*, 64 CONSUMER FIN. L.Q. REP. 4 (2010).

4. Pub. L. No. 90-321, 82 Stat. 146 (1968) (codified as amended at 15 U.S.C.A. §§ 1601–1667f (West 2009 & Supp. 2010)); see also 12 C.F.R. pt. 226 (2010) (Federal Reserve Board Regulation Z); Catherine M. Brennan, Jeffrey P. Naimon & Jacqueline A. Parker, *Truth in Lending Update—2010*, 66 BUS. LAW. 413 (2011) (in this *Annual Survey*).

5. Pub. L. No. 93-533, 88 Stat. 1724 (1974) (codified as amended at 12 U.S.C. §§ 2601–2617 (2006)); see, e.g., John P. Kromer, Sanford Shatz & Jonathan W. Cannon, *2010 Survey of RESPA Developments*, 66 BUS. LAW. 435 (2011) (in this *Annual Survey*).

6. See generally Bryce, *supra* note 3 (listing other defenses).

a loan modification, or that the borrower was otherwise harmed during the loan modification process.⁷

A loan modification, broadly defined, reduces or delays loan payments on an existing loan in order to make the loan more affordable for the borrower, and to avoid default.⁸ Related, but somewhat different, are forbearance plans in which the monthly payments are reduced or forgiven on a temporary basis to allow the borrower to return to currency; the borrower then usually resumes making the original payments. Servicers may provide these benefits by reducing the interest rate, extending the loan term, rearranging the timing of payments, reducing the loan principal, or some combination of the above.

In 2009, the Obama Administration instituted the Home Affordable Modification Program (“HAMP”), along with a variety of similar subprograms.⁹ As explained below, borrowers have now begun to invoke HAMP and its progeny as the basis for a right to a loan modification and, in addition, are articulating a variety of common law theories that they claim create a right to a loan modification. This survey discusses this broad trend and describes the near universal dismissal of such claims.

This discussion begins by describing the landmark HAMP program in general, before discussing many of the cases where courts have held that the borrowers possess no private right of action for its enforcement, and no right to a loan modification even if they qualify under HAMP’s guidelines. The survey then describes

7. See *infra* notes 30–68 and accompanying text.

8. See, e.g., Stephen FJ. Ornstein, Matthew S. Yoon & John P. Holahan, *The FHA Home Affordable Modification Loss Mitigation Option*, 63 CONSUMER FIN. L.Q. REP. 289, 289 (2009).

9. See, e.g., HAMP Supplemental Directive 09-01, at 1 (Apr. 6, 2009), available at http://www.hpinc.org/_uls/resources/Supplemental_Directive_09-0.pdf [hereinafter SD 09-01]. The subprograms are myriad, and include modification programs for second mortgages (called “2MP”), special provisions for unemployed borrowers who lack income (they can receive a short moratorium on payments as part of the “UP” program), refinancing for borrowers who are underwater (“FHA2LP”), and short sale incentives (“HAFSA”). See HOME AFFORDABLE MODIFICATION PROGRAM, <https://www.hmpadmin.com/portal/index.html> (under the “Programs” tab) (last visited Oct. 18, 2010). More such programs are likely forthcoming. All of these programs fall under the United States Treasury’s jurisdiction and are part of the broader “Making Home Affordable” program, of which HAMP is the flagship. *Id.* In addition, there are numerous sub-guidelines depending on whether the loan is FHA insured or owned by one of the GSEs, Fannie Mae or Freddie Mac. Fannie Mae, for example, offers a program called “Alt-Mod” in which otherwise ineligible borrowers can qualify for a HAMP-like loan modification if they were offered a HAMP trial and made trial period payments on time. See Fannie Mae, Frequently Asked Questions: Lender Letter LL-2010-04; Fannie Mae’s Alternative Modification to the Home Affordable Mortgage Program (June 3, 2010), available at <https://www.efanniemae.com/sl/sf/servicing/altmod/pdf/llaltmodfaqs.pdf>.

For all of these subprograms, the general concepts are the same, i.e., monthly payments at 31 percent of monthly gross income for some period of time, with government incentives, and no servicer being required to take unprofitable actions. *Id.* Further details are noted below, but are otherwise beyond the scope of this survey. The reader should simply be aware that more specialized guidelines may be applicable in particular cases. See, e.g., Ornstein, Yoon & Holahan, *supra* note 8, at 295–304 (describing FHA-HAMP in detail). Finally, it bears noting that some pre-HAMP legacy programs remain in effect, such as the Hope for Homeowners Program. See, e.g., Stephen FJ. Ornstein, Matthew S. Yoon, David A. Tallman & John P. Holahan, *The Housing and Economic Recovery Act of 2008*, 61 CONSUMER FIN. L.Q. REP. 944, 947–48 (2007).

how borrowers have attempted to pursue constitutional, statutory, and common law claims outside of HAMP as the basis for a right to a loan modification, including allegations of constitutional violations, racial discrimination in modifying loans, and false advertising by servicers in offering the possibility of a loan modification. As discussed below, these causes of action also have largely been dismissed.

Finally, this survey provides commentary on some of the new theories that are only now beginning to be asserted and have yet to work their way through the courts, including lawsuits by investors to stop or recoup their losses from loan modifications, and lawsuits based on a failure to send adverse action notices under the Equal Credit Opportunity Act (“ECOA”).¹⁰

OVERVIEW OF HAMP

INTRODUCTION

In early 2009, the United States Department of the Treasury (“Treasury”) first announced HAMP, a national modification program intended to help three to four million at-risk homeowners avoid defaulting on their mortgage loans by reducing their monthly loan payments.¹¹ Servicers voluntarily enter the HAMP program by executing a Servicer Participation Agreement (“SPA”) “with Fannie Mae in its capacity as financial agent for the United States.”¹² On August 20, 2010, the Treasury published a servicer manual that contains detailed program guidelines for HAMP.¹³

WHAT DOES HAMP DO FOR HOMEOWNERS?

Greatly simplified, HAMP reduces a borrower’s monthly payment to 31 percent of his or her pre-tax monthly income (a number the government considers presumptively affordable).¹⁴ Under the guidelines in effect at the time of this writing, HAMP accomplishes this by reducing the interest rate to as low as 2 percent, extending the term to up to forty years, and forbearing up to \$30,000 in principal.¹⁵ If,

10. See *infra* notes 69–84 and accompanying text; Laura C. Baucus, Joseph H. Hickey & Michael J. Blalock, *Emerging Topic: Is a Loan Modification “Credit” Under the Equal Credit Opportunity Act? According to the Fed, It Is*, 64 CONSUMER FIN. L.Q. REP. 155 (2010).

11. See SD 09-01, *supra* note 9, at 1.

12. *Id.* For a list of current HAMP servicers, see *Mortgage Servicer List*, MAKING HOME AFFORDABLE, http://www.makinghomeaffordable.gov/contact_servicer.html (last visited Oct. 18, 2010). A template servicer participation agreement may be reviewed at *Home Affordable Modification Program: Servicer Participation Agreement*, MAKING HOME AFFORDABLE, https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/servicerparticipationagreement.pdf (last visited Dec. 2, 2010).

13. See MAKING HOME AFFORDABLE PROGRAM: HANDBOOK FOR SERVICERS OF NON-GSE MORTGAGES (Sept. 22, 2010), available at https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/mhahandbook_20.pdf [hereinafter SERVICER MANUAL].

14. *Id.* at 37–38.

15. *Id.* at 37–41. The process followed is referred to as “The Waterfall.” *Id.* at 37.

after making those changes to the loan terms, a 31 percent payment cannot be achieved, the loan does not qualify for HAMP.¹⁶ In addition, after making those changes, the servicer or lender performs a net present value (“NPV”) test to determine whether it would be more profitable to modify the loan at those terms or simply to foreclose.¹⁷ If foreclosure is more profitable, the loan does not qualify for HAMP.¹⁸ HAMP provides substantial government subsidies to borrowers who successfully make the modified payments, and to the investors on the loan who suffer the loss from a reduced payment stream; loan servicers receive a small incentive as partial compensation for processing the application and coordinating the modification paperwork.¹⁹

Assuming the borrower meets the HAMP qualifications, the borrower will be placed into what is called a HAMP Trial Period Plan (“TPP”).²⁰ During the TPP, the borrower makes three or more trial payments at the proposed modification amount.²¹ If the borrower makes the payments and otherwise remains qualified, the HAMP TPP converts to a permanent modification.²² Prior to June 1, 2010, borrowers could be placed into a TPP based on stated income alone, while permanent modifications could only be generated based on verified income.²³ This often resulted in borrowers mistakenly believing they had qualified for the program initially only to be disqualified from the program once their true income was verified.²⁴

16. *Id.*

17. *Id.* at 43.

18. *Id.* at 43–46 (describing the NPV test).

19. *Id.* at 59. “Borrowers whose monthly payment . . . is reduced through the HAMP by six percent or more and who make timely monthly payments will earn . . . the lesser of: (1) \$1,000 . . . or (ii) [o]ne-half of the reduction in the borrower’s annualized monthly payment for each month a timely payment is made.” *Id.* Investors receive 50 percent of the difference between original and modified payments (with some complicated exceptions). *Id.* Servicers currently receive a flat \$1,000 for every loan permanently modified under HAMP. *Id.* at 58.

20. *Id.* at 46–47 (describing the TPP).

21. *Id.* at 46.

22. *Id.*

23. HAMP Supplemental Directive 10-01, at 1 (Jan. 28, 2010), available at https://www.hmpad.mn.com/portal/programs/docs/hamp_servicer/sd1001.pdf [hereinafter SD 10-01].

24. Borrowers have filed lawsuits in Massachusetts, Illinois, and elsewhere, alleging that the TPP contractually promises a permanent loan modification. See *infra* notes 37–39 and accompanying text. However, the HAMP guidelines explicitly state otherwise, and courts repeatedly have held that HAMP lacks an enforcement mechanism. In the Massachusetts and Illinois cases, the plaintiffs have attempted to circumvent the rulings by pleading state and common law claims. Cases filed in the U.S. District Court for the District of Massachusetts include the following: *Belyea v. Litton Loan Servicing, LLP*, No. 10-10931 (D. Mass. filed June 4, 2010); *Durmick v. J.P. Morgan Chase Bank, N.A.*, No. 10-10380 (D. Mass. filed Mar. 3, 2010); *Bosque v. Wells Fargo Bank, N.A.*, No. 10-10311 (D. Mass. Feb. 23, 2010); *Johnson v. BAC Home Loans Servicing, LP*, No. 10-10316 (D. Mass. filed Feb. 23, 2010). Cases filed in the U.S. District Court for the Northern District of Illinois include the following: *Wigod v. Wells Fargo Bank, N.A.*, No. 10-2348 (N.D. Ill. filed Apr. 15, 2010); *Fletcher v. IndyMac Mortg. Servs., FSB*, No. 10-04682 (N.D. Ill. filed July 27, 2010). Under the latest HAMP guidelines, a servicer may not offer a TPP to a borrower until first fully verifying the borrower’s income. See *SERVICER MANUAL*, *supra* note 13, at 28–29. This change in the HAMP guidelines may moot these lawsuits.

OTHER LIMITS ON HAMP

Some borrowers and members of the public mistakenly view HAMP as creating a kind of automatic or legal right to a loan modification, perhaps because the media has sometimes advanced that perception. As just one notable example, a former “Real Housewives of Orange County” star reportedly was shocked and “incensed” to discover that her \$4.5 million residence did not qualify for HAMP.²⁵ However, HAMP sets a maximum property value well under one million dollars for single family homes to qualify.²⁶ In addition to the strict qualification requirements, borrowers who enter the HAMP program must send in documents to verify their income at multiple times to ensure that the financial information is current.²⁷

HAMP IS BASED ON MORTGAGEES ACTING IN THEIR OWN FINANCIAL INTEREST

Lawsuits invoking HAMP sometimes begin on the mistaken premise that a lawsuit is necessary to force the bank or other mortgagee to comply with new government regulations that some envision as providing special protections to homeowners. But HAMP was deliberately designed to create loan modifications only where the mortgagee already has a profit motive for doing so. HAMP achieves this by the NPV test, which is designed to evaluate whether foreclosure or modification would be more profitable.²⁸ Thus, the cases noted below are largely being brought to try to compel loan servicers to do what their economic incentives would in any event already dictate.²⁹

LAWSUITS BASED ON HAMP

BORROWERS LACK STANDING TO SUE UNDER HAMP

To date, courts have universally dismissed lawsuits brought by borrowers alleging that their loan servicers violated the HAMP guidelines, i.e., that the servicer

25. Sheree R. Curry, *Sue Your Lender, Save Your Home*, AOL HOUSING WATCH (Mar. 16, 2010), <http://www.housingwatch.com/2010/03/16/sue-your-lender-save-your-home/11>. The Housewife ultimately received a non-HAMP loan modification from her lender. *Id.*

26. See SERVICER MANUAL, *supra* note 13, at 18.

27. See, e.g., SD 09-01, *supra* note 9, at 5–8 (describing the documentation requirements). Later Supplemental Directives provide more detail about what documents are needed in specific cases, and the Servicer Manual provides the greatest detail. See SERVICER MANUAL, *supra* note 13, at 31–33.

28. SERVICER MANUAL, *supra* note 13, at 43–46.

29. Indeed, some members of Congress lamented that this design aspect is not tough enough on the mortgagee:

The central flaw of [the legislation] is that there are no stronger protections for homeowners and no changes in the language to ensure that the [Treasury] secretary has the authority to compel mortgage servicers to modify the terms of mortgages We could have demanded language in the legislation that would have empowered the Treasury to compel mortgage servicers to rework the terms of mortgage loans so homeowners could avoid foreclosure.

154 CONG. REC. H10766 (daily ed. Oct. 3, 2008) (statement of Rep. Dennis Kucinich, D-OH).

failed to modify an eligible loan, or failed to follow the procedural guidelines about the timing of loan modification offers, the order of the waterfall, the use of a forbidden variable in the NPV test, or a similar requirement. Courts have dismissed these cases on two bases.

First, HAMP creates no private right of action; only the government is empowered to enforce its provisions.³⁰ Thus, even where borrowers allege a material violation of the HAMP guidelines, those violations are not actionable by borrowers.³¹

Second, courts have rejected the borrowers' theory that they are intended third-party beneficiaries of the SPA entered into between loan servicers and the federal government.³² These courts have concluded that borrowers "generally are assumed to be incidental beneficiaries, rather than intended beneficiaries," of government contracts.³³ Further, the HAMP contracts do not specifically identify borrowers as third-party beneficiaries, and even if they did, a demonstration that the contract benefits the borrowers directly would not be sufficient to confer standing.³⁴ Of greater significance, the HAMP contracts do not mandate that eligible loans be modified, and thus, even the government cannot sue under the circumstances usually presented by borrowers.³⁵ Finally, as one court noted, "the breadth and indefiniteness of a class of beneficiaries" tends to negate any inference of intended beneficiary status.³⁶

BORROWERS LACK STANDING TO STOP FORECLOSURES BASED ON HAMP GUIDELINES

HAMP-based claims sometimes arise in the context of contested foreclosures. In these suits, borrowers may allege they had a HAMP application pending review, or were placed into a HAMP TPP, but their servicer attempted to foreclose anyway.³⁷ The HAMP guidelines explicitly require foreclosure sales to be postponed once a

30. See, e.g., *Adams v. U.S. Bank*, No. 10-10567, 2010 WL 2670702, at *4 (E.D. Mich. July 1, 2010); *Hoffman v. Bank of Am., N.A.*, No. C 10-2171 SI, 2010 WL 2635773, at *5 (N.D. Cal. June 30, 2010); *Zendejas v. GMAC Wholesale Mortg. Corp.*, No. 1:10-CV-00184 OWW GSA, 2010 WL 2629899, at *4 (E.D. Cal. June 29, 2010); *Simmons v. Countrywide Home Loans, Inc.*, No. 09cv1245 JAH(JMA), 2010 WL 2635220, at *5 (S.D. Cal. June 29, 2010); *Simon v. Bank of Am., N.A.*, No. 10-cv-00300-GMN-LRL, 2010 WL 2609436, at *10 (D. Nev. June 23, 2010); *Marks v. Bank of Am., N.A.*, No. 03:10-cv-08039-PHX-JAT, 2010 WL 2572988, at *5-7 (D. Ariz. June 22, 2010).

31. See, e.g., *Simon*, 2010 WL 2609436, at *13 ("[I]t is undisputed that Defendants have an obligation to follow [HAMP] guidelines, but as discussed above, borrowers do not have standing to challenge Defendants' compliance.").

32. See, e.g., *Marks*, 2010 WL 2572988, at *4-5. Courts generally discuss both lack of a private right and third-party beneficiary principles in dismissing HAMP claims. See cases cited at *supra* note 30.

33. *Villa v. Wells Fargo Bank, N.A.*, No. 10-CV-81 DMS (WVG), 2010 WL 935680, at *2 (S.D. Cal. Mar. 15, 2010).

34. *Id.* (quoting *Cnty. of Santa Clara v. Astra USA, Inc.*, 588 F3d 1237, 1244 (9th Cir. 2009)).

35. See *Escobedo v. Countrywide Home Loans, Inc.*, No. 09-CV-1557 BTM (BLM), 2009 WL 4981618, at *3 (S.D. Cal. Dec. 15, 2009).

36. *Villa*, 2010 WL 935680, at *3 n.1 (quoting *Cnty. of Santa Clara*, 588 F3d at 1244).

37. See, e.g., *id.* at *1.

HAMP application is pending.³⁸ However, the courts have held that plaintiffs lack standing to stop a foreclosure sale based on those HAMP guidelines even where a HAMP application has been submitted.³⁹

CONSTITUTIONAL CLAIMS

A few plaintiffs have claimed a constitutional right to a loan modification, and at least one such lawsuit has survived dismissal. In *Huxtable v. Geithner*,⁴⁰ the borrower asserted that the lender and the federal government jointly violated his constitutional Fifth Amendment right to due process via the creation of HAMP and subsequently conspired to deprive borrowers of their rights under the program. The Fifth Amendment generally does not apply to private parties, such as loan servicers, but in *Huxtable* the borrower argued that HAMP created joint action by the government and the loan servicer.⁴¹ The court agreed that the plaintiffs had stated a claim: “Plaintiffs contend that the government required private lenders to participate [in HAMP] if they have received federal [TARP and stimulus] money, and the private lenders must administer HAMP on the government’s behalf. Whether this is correct or not is not an issue that can be determined on the record before the Court.”⁴²

Huxtable appears to be an anomalous decision. In *Williams v. Geithner*,⁴³ the court dismissed comparable Fifth Amendment procedural due process claims brought against the government. In *Williams*, the plaintiffs alleged that they were denied a loan modification under the HAMP guidelines as enacted by the government and as applied by their servicer.⁴⁴ The plaintiffs claimed that the government HAMP guidelines unconstitutionally failed to provide the borrower any ability to appeal.⁴⁵ The court held that HAMP creates no property interest in a loan modification, and thus, there was no Fifth Amendment claim for the denial of a loan modification, or the lack of an appellate procedure: “The [HAMP authorizing] statute does not create an absolute duty on the part of the Secretary to consent to loan modifications.”⁴⁶

ALLEGED RACIAL DISPARITIES IN THE LOAN MODIFICATION PROCESS

In at least three decisions, federal courts have dismissed claims of race discrimination in failing to offer or consider the borrower for a loan modification. In *Wil-*

38. See SERVICER MANUAL, *supra* note 13, at 26–27. Of note, the guidelines require servicers to actively solicit borrowers’ participation in HAMP. *Id.* at 21–22. We believe that most servicers now inform all borrowers who are behind on their payments of the existence of HAMP and offer some time, usually thirty days, to send in an application.

39. See *Hoffman v. Bank of Am., N.A.*, No. 10-2171 SI, 2010 WL 2635773, at *4–5 (N.D. Cal. June 30, 2010); *Villa*, 2010 WL 935680, at *2–3.

40. No. 09-CV-1846, 2009 WL 5199333 (S.D. Cal. Dec. 23, 2009).

41. *Id.* at *2.

42. *Id.* at *3.

43. No. 09-1959, 2009 WL 3757380 (D. Minn. Nov. 9, 2009).

44. *Id.* at *4.

45. *Id.*

46. *Id.*

lis v. Countrywide Home Loans Servicing, L.P.,⁴⁷ the borrower alleged that his loan modification application was treated less favorably than non-minorities' applications. The court noted that the plaintiff had failed to allege how any non-minority applicant got better treatment, and concluded: "Countrywide's eligibility criteria for its loan modification programs . . . appear to have been based on race-neutral criteria, such as payment history, employment status, and whether a borrower had previously participated in a loan modification program."⁴⁸

In *Adams v. U.S. Bank*,⁴⁹ the plaintiff alleged that the bank failed to provide her a loan modification due to her race. She claimed the bank offered a HAMP modification as a technical matter but that, in fact, the bank was pretending the HAMP offer did not exist, by, for example, losing or destroying income documents she sent in support of her application.⁵⁰ While the complaint appears to have been inartfully drafted, the court interestingly remarked that it did not see how the plaintiff's supposed reliance on the bank's promise to consider her HAMP application could have led to any detriment: "[T]he fact that [the defendant] may have informed Plaintiff that it would consider her for a loan modification and then lost or destroyed her loan modification application does not imply that she suffered injury as a result. Plaintiff already was indebted for the amount of the mortgage."⁵¹

Similarly, in *Mbaba v. Indymac Federal Bank, F.S.B.*,⁵² the court rejected the borrower's conclusory assertions that the bank and its agents set higher interest rates for modifications to minorities and otherwise offered less favorable modification terms, or less often offered modifications, to minority borrowers.⁵³

FORECLOSURES MAY MOVE FORWARD DESPITE PENDING LOAN MODIFICATION APPLICATIONS

Several borrowers have asserted that their servicers solicited their application for a loan modification, and that by this solicitation the servicer effectively offered a loan modification.⁵⁴ The courts have rejected this argument. In *Anderson v. Fremont Investment & Loan*, for example, the court held that a lender's invitation to the borrower to apply for a loan modification did not justify reliance so as to estop the lender from foreclosing, nor did it prevent the lender from continuing with the foreclosure even after the borrower applied.⁵⁵

47. No. CCB-09-1455, 2009 WL 5206475 (D. Md. Dec. 23, 2009).

48. *Id.* at *8.

49. No. 10-10567, 2010 WL 2670702 (E.D. Mich. July 1, 2010).

50. *Id.* at *3.

51. *Id.* at *4.

52. No. 1:09-CV-01452-OWW-GSA, 2010 WL 424363 (E.D. Cal. Jan. 27, 2010).

53. *Id.* at *5.

54. See, e.g., *Anderson v. Fremont Inv. & Loan*, No. 287397, 2009 WL 3837359 (Mich. Ct. App. Nov. 17, 2009).

55. *Id.* at *4.

Other borrowers have similarly argued that their servicer's allusions to a possible loan modification should prevent a pending foreclosure. The courts likewise have rejected these arguments, even where the servicer has made seemingly firm promises about a loan modification. For example, in *Rodriguez v. OneWest Bank*,⁵⁶ the borrower alleged that the bank promised to postpone a foreclosure sale while evaluating the borrower for a loan modification. After he sent in the application package, the bank proceeded with a non-judicial foreclosure.⁵⁷ The court dismissed the borrower's claims for lack of specificity.⁵⁸

Even when more facts are pled, such claims still have failed. In *Kincaid v. Wells Fargo Bank, N.A.*,⁵⁹ the borrower similarly alleged a promise not to foreclose while a loan modification application was pending. Even assuming the facts as pled, the court concluded that the allegations could not give rise to a breach of contract claim because the original loan agreements lacked any promise to postpone foreclosure sales during the pendency of a loan modification application.⁶⁰ Moreover, there could be no breach of the implied covenant of good faith and fair dealing because the oral promise occurred long after the loan was originated, and thus fell "outside the scope" of the governing contract.⁶¹ Finally, the mortgagee did not owe any fiduciary duty to its borrower that would prevent it from renegeing on its gratuitous oral representation.⁶²

In a case with perhaps the best possible set of facts for the borrower, the court still dismissed the lawsuit. In *Stevens v. JPMorgan Chase Bank, N.A.*,⁶³ the borrower alleged he was told by a customer service representative that the servicer could "likely" work out a loan modification in lieu of foreclosure, but the lender ultimately denied the loan modification application.⁶⁴ Among other things, the borrower claimed fraud and false advertising on the basis of credible statistics showing that less than 20 percent of loan modification applications reviewed by the defendant were eventually approved.⁶⁵ Thus, he argued, the representative's representation of any likelihood of a loan modification was a fraudulent statement and constituted false advertising.⁶⁶ However, the court disagreed, dismissing both claims.⁶⁷ Absent an explicit guarantee, the court concluded that the borrowers had failed to allege "that the challenged advertising [was] false or misleading to a reasonable consumer."⁶⁸

56. No. CV09-2361-PHX-NVW, 2010 WL 550760 (D. Ariz. Feb. 16, 2010).

57. *Id.* at *1.

58. *Id.* at *2.

59. 2010 WL 2899058 (D. Ariz. July 22, 2010).

60. *Id.* at *2.

61. *Id.* at *3.

62. *Id.* at *4.

63. No. C 09-03116 SI, 2010 WL 329963 (N.D. Cal. Jan. 20, 2010).

64. *Id.* at *1.

65. *Id.* at *5-6.

66. *Id.*

67. *Id.* at *4-7.

68. *Id.* at *5 (quoting *Nat'l Council Against Health Fraud, Inc. v. King Bio Pharms., Inc.*, 133 Cal. Rptr. 2d 207, 213 (Ct. App. 2003)).

THE NEW FRONTIER: EMERGING AND ANTICIPATED LOAN MODIFICATION LITIGATION

THE INVESTORS STRIKE BACK

Investors have not sat idly while mortgage servicers modify (and reduce) their income stream. For example, investors filed suit in *Greenwich Financial Services Distressed Mortgage Fund 3, LLC v. Countrywide Financial Corp.*⁶⁹ The investors sued for breach of contract under their pooling and servicing agreement, arguing that under the terms of that agreement, Countrywide, the originator and seller of the loans, was required to repurchase loans at their original value whenever it agreed to loan modifications.⁷⁰

Countrywide removed the case to federal court based on federal question jurisdiction.⁷¹ The court remanded to state court, and the U.S. Court of Appeals for the Second Circuit affirmed.⁷² The district court found that this lawsuit, and presumably all similar lawsuits based on pooling and servicing agreements, was a lawsuit that “solely involves a claim . . . that relates to the rights, duties (including fiduciary duties), and obligations relating to or created by or pursuant to any security.”⁷³ Such lawsuits are delineated exceptions to the broad grant of federal jurisdiction under the Class Action Fairness Act.⁷⁴ The district court also rejected arguments that federal questions were raised because interpretation of federal law would be necessary for interpreting the agreements; instead, it found that the investors’ claims were garden-variety breach of contract theories that required no special analysis of federal law in order to be adjudicated.⁷⁵ One suspects more such investor suits, alleging losses arising out of loan modifications (HAMP or otherwise), will work their way through state courts in the next few years.

TRADITIONAL ECOA SUITS WEARING NEW LOAN MODIFICATION CLOTHING

Several class action lawsuits based on the Equal Credit Opportunity Act (“ECOA”) allege that a failure to issue prompt HAMP denial notices constitutes an adverse action.⁷⁶ HAMP guidelines require that notice of denial be sent to the borrower within ten business days of the decision.⁷⁷ The ECOA does not require

69. 654 F. Supp. 2d 192 (S.D.N.Y. 2009).

70. *Id.* at 194.

71. *Id.*

72. *Id.* at 204; *Greenwich Fin. Servs. Distressed Mortg. Fund 3, LLC v. Countrywide Fin. Corp.*, 603 F.3d 23, 32 (2d Cir. 2010).

73. *Greenwich*, 654 F. Supp. 2d at 195 (quoting 28 U.S.C. § 1332(d)(9)(C)).

74. *Greenwich*, 603 F.3d at 28–31.

75. *Greenwich*, 654 F. Supp. 2d at 201–04.

76. *See, e.g.*, Complaint, *Foster v. Am. Home Mortg. Servicing, Inc.*, No. 10-cv-10008 (E.D. Mich. filed Jan. 4, 2010).

77. HAMP Supplemental Directive 09-08, at 2–4 (Nov. 3, 2009), available at https://www.hmpad.min.com/portal/programs/docs/hamp_servicer/sd0908.pdf [hereinafter SD 09-08] (providing model clauses for various denial reasons).

that an adverse action notice be sent to borrowers already in default, or even just delinquent.⁷⁸ However, HAMP allows borrowers who are current on their payments to apply for HAMP if they document an imminent risk of default.⁷⁹

Whether or not the ECOA supports this as a matter of statutory analysis, the Federal Reserve Board has now argued that the ECOA requires an adverse action notice within thirty days whenever non-defaulted borrowers are denied under HAMP.⁸⁰ This assertion conflicts with other federal regulations that provide that “[a] refusal to extend credit because applicable law prohibits the creditor from extending the credit requested” is not an adverse action under the ECOA.⁸¹ A borrower who fails to qualify for HAMP is presumably one to whom “applicable law” prohibits extensions of credit under the program. Nor is it apparent that any kind of loan modification decision could require ECOA notice.⁸² Note, however, that if the ECOA adverse action requirement does apply, a simple letter stating that the application was denied will not be sufficient—the ECOA requires a full description of the reasons for denial.⁸³ Thus, the model denial letters provided by the Treasury for HAMP rejections arguably would not pass ECOA muster.⁸⁴

GOVERNMENT LAWSUITS

At the time of this writing, it is unknown how vigorously the Treasury will attempt to enforce the HAMP guidelines, or what sanctions may be applied. As of this writing, HAMP enforcement by the Treasury has been minimal to nonexistent, but the United States Attorney General’s Office has promised to monitor HAMP data closely for racial disparities.⁸⁵ One problem with this inquiry is that servicers have little discretion under the HAMP program. The HAMP guidelines, written by the Treasury, presumably incorporate only race-neutral decision-making factors. Under other circumstances, applying objective, race-neutral creditworthiness factors to lending decisions might still create a disparate impact, and lenders have

78. ECOA § 701(d)(6), 15 U.S.C. § 1691(d)(6) (2006); 12 C.F.R. § 202.2(c)(2)(ii) (2010) (no notice required after “any action or forbearance relating to an account taken in connection with inactivity, default, or delinquency as to that account”).

79. See SD 09-01, *supra* note 9, at 3–4.

80. Letter from Federal Reserve Bank of San Francisco to State Member Banks 1–2 (Dec. 23, 2009) (citing 12 C.F.R. § 202.9), available at <http://www.frbsf.org/banking/letters/2009/1223a.pdf>; see also Baucus, Hickey & Blalock, *supra* note 10, at 156–57.

81. 12 C.F.R. § 202.2(c)(2)(iv) (2010).

82. See 15 U.S.C. § 1691a(b) (2006) (defining ECOA “applicant” as one who applies for an “extension, renewal, or continuation of credit”). Loan modifications, a mutually agreed *reduction* in credit, do not fit this definition.

83. ECOA § 503, 15 U.S.C. § 1691(d)(3) (2006).

84. See SD 09-08, *supra* note 77, at 2–4.

85. In testimony before Congress in April 2010, Assistant Attorney General Thomas Perez promised to evaluate newly collected HAMP data for racial disparities. See Press Release, U.S. Dept’t of Justice, Assistant Attorney General Thomas E. Perez Testifies Before the House Subcommittee on the Constitution, Civil Rights, and Civil Liberties (Apr. 29, 2010), available at <http://www.justice.gov/crt/speeches/2010/crt-speech-100429.html>.

had to defend against such claims in the past in the origination context.⁸⁶ But the detailed HAMP guidelines completely change the analysis. Can plaintiffs seriously argue that servicers are liable for creating a disparate impact by applying HAMP's race-neutral guidelines as part of a federal program? One suspects a federal circuit court of appeals will be called upon to answer that question, or something like it, within the next five years.

States may end up playing some role as well. Already, Ohio's Attorney General has filed a lawsuit against a servicer, claiming inadequate or incompetent customer service in administering HAMP.⁸⁷ And in July 2010, the Illinois legislature enacted a statute preventing foreclosure wherever HAMP's guidelines were not followed.⁸⁸ It is too early to know how courts will interpret the new Illinois law, but it is reasonable to expect the law to be read narrowly in light of likely federal preemption, in addition to HAMP lacking any private enforcement mechanisms.

86. See, e.g., *Beaulialice v. Fed. Home Loan Mortg. Corp.*, No. 8:04-CV-2316-T-24-EAJ, 2007 WL 744646, at *4-5 (M.D. Fla. Mar. 6, 2007) (noting that lender could be liable for disparate impact despite using objective, race-neutral creditworthiness factors in lending decisions, but granting lender summary judgment due to the statute of limitations).

87. See Complaint, *Ohio v. Barclays Capital Real Estate, Inc.*, No. 09 10136 (Montgomery Cnty. Common Pleas Ct. filed Dec. 16, 2009).

88. 2010 Ill. Pub. Act 096-1245 (July 23, 2010) (HB 5735) (to be codified at 735 ILL. COMP. STAT. 5/15-1508).