NEGOTIATIONS FOR THE HOME: A BALANCED APPROACH TO GOOD FAITH IN FORECLOSURE MEDIATION

HANNAH COSTIGAN-COWLES

The high foreclosure rate for residential properties in the United States has caused millions of Americans to be cast out of their homes and investors to incur massive financial losses. With the foreclosure crisis continuing and foreclosure filings expected to increase, all levels of government continue to search for a solution that will address the problems faced by affected parties. One popular method adopted by courts and legislatures at the state and local level has been to use foreclosure mediation programs. At a minimum, these programs provide for some contact between a servicer and a borrower before resorting to a foreclosure sale. Developers of mediation programs, however, have struggled to create a system that encourages meaningful participation and provides parties with a reasonable chance for beneficial outcomes. This Note presents an analysis of the use of foreclosure mediation programs by various jurisdictions and the praise and criticism of the programs, including the advantages and disadvantages of good faith participation requirements within such programs. Ultimately, this Note recommends that foreclosure mediation programs require good faith participation using objective standards and impose sanctions for failure to comply with those standards.

I. INTRODUCTION

As of 2010, one in thirty-three homeowners nationwide faced foreclosure, a huge jump from the foreclosure rate of 1.1% in 2004 before the housing crisis began.[1] This dramatic increase in foreclosures has caused widespread problems throughout the entire country, not just for struggling homeowners.[2] The situation has become so dire that architects have developed a new initiative to reconsider the traditional city to "catalyze urban transformation" in the face of "nationwide challenges . . . including a significant rate of foreclosure."[3] The construction industry

1. Kim Rueben & Serena Lei, *What the Housing Crisis Means for State and Local Governments*, LAND LINES, Oct. 2010, at 8, 12.

2. There are many problems linked to the foreclosure crisis, including the current economic crisis. The list provided is not meant to be exclusive.

3. *MoMA Announces FORECLOSED: REHOUSING THE AMERICAN DREAM*, BWWARTWORLD.COM (Feb. 2, 2012, 7:01 PM), http://art.broadwayworld.com/article/MoMA-Announces-FORECLOSED-REHOUSING-THE-AMERICAN-DREAM-20120202.

faced a seventy-five percent drop in the construction of new houses from 2006 to 2009.[4] This drop, in conjunction with the heightened availability of foreclosed houses selling for bargain prices, means that many people can no longer afford to build new homes.[5] Additionally, financial institutions holding mortgages have struggled to keep up with the seemingly endless stream of new foreclosures.[6] Finally, in many areas the rising number of vacant homes has created havens for criminal behavior and vandalism, which has further reduced property values.[7]

With many areas continuing to face high foreclosure rates,[8] all levels of government continue to search for a solution that will address the problems faced by affected parties. One popular method among courts and legislatures at the state and local level has been to adopt foreclosure mediation programs. Partly as a result of structural problems within financial institutions, however, developers of mediation programs have struggled to create a system that encourages meaningful participation and provides parties with a reasonable chance for beneficial outcomes. This Note recommends that foreclosure mediation programs follow the lead of some jurisdictions, including New York and Nevada, in requiring good faith participation and imposing sanctions for failure to comply with that requirement.

In arriving at the conclusion that good faith participation combined with meaningful sanctions is necessary to an effective foreclosure mediation program, this Note examines the various understandings of what it means to participate in a mortgage foreclosure mediation in "good faith" as well as what the most appropriate and productive sanctions are. Part II begins by looking at the economic setting (and crisis) in which mortgage foreclosure mediation has developed. Next, this Part presents the various alternatives that may be available in lieu of foreclosure and concludes with details of specific responses that the federal, state, and local governments have adopted.

Part III delves deeper into the use of the foreclosure mediation program by various jurisdictions and the praise and criticism of the programs. Section A discusses and ultimately concludes that mortgage foreclosure mediation is a good idea, and Section B moves on to consider the advantages and disadvantages of good faith participation requirements within such programs. Section C next addresses in more detail the possible structure of a good faith requirement, and Section D lays out poten-

4. Rueben & Lei, *supra* note 1, at 8.

5. Derek Kravitz, *Foreclosure Crisis Helps Make New Homes a Bad Deal*, HUFFINGTON POST (Mar. 22, 2011, 6:45 PM), http://huffingtonpost.com/2011/03/23/foreclosure-crisis-new-homes_n_839442.html.

6. Arthur Delaney & Ryan Grim, *Short Sales: Banks Blocking Way Out of Foreclosure Crisis*, HUFFINGTON POST (June 8, 2009, 6:12 AM), http://www.huffingtonpost.com/2009/05/08/short-sales-banks-blockin_n_199099.html.

7. Dan Immergluck & Geoff Smith, *The Impact of Single-Family Mortgage Foreclosures on Neighborhood Crime*, 21 HOUSING STUD. 851, 863 (2006).

8. Mamta Badkar, *The 17 Cities with the Highest Foreclosure Rates in America*, BUS. INSIDER (Feb. 17, 2013. 6:46 AM), http://www.businessinsider.com/cities-with-high-foreclosure-rates-2013-2.

tial sanctions for parties who do not participate in mediation in good faith. The goal of this Part is to devise the best strategy for creating an effective program. Finally, Part IV presents recommendations about how best to implement a plan for foreclosure mediation with a good faith requirement. Part V concludes.

II. BACKGROUND

The conclusion that a foreclosure mediation program is beneficial rests on the premise that a problem exists. This Part outlines the foreclosure crisis and the possible and attempted solution. Section A begins by describing the financial crisis with a particular emphasis on the resultant spike in foreclosures and the impacts of that boom. Section B addresses some of the options available to homeowners seeking to avoid foreclosure, including options for those who wish to stay in their homes and those who instead seek some kind of graceful exit. Finally, Section C looks at steps state and local governments have already taken in an effort to ameliorate the problems outlined in Section A.

A. The Crisis

Leading up to the foreclosure crisis in 2007, banks began extending credit much more readily with less concern for the financial situation of those to whom they were lending.[9] This increased credit extension resulted primarily from the entry of the private banking sector into the mortgage bond market.[10] This entry meant that banks could offer mortgages to would-be homeowners and sell the risk to investors for a profit.[11] As a result of this practice, banks began to offer loans to individuals who previously would have been denied, including subprime borrowers with weak credit and income histories.[12] According to the FDIC, "[t]he term 'subprime' refers to the credit characteristics of individual borrowers," not the loans themselves.[13] Although subprime lending is often equated with predatory lending, the two categories of loan do not always overlap.[14] Nonetheless, such borrowers, who are usually working class families, are often offered very attractive initial interest rates and opportuni-

9. *The U.S. Subprime Crisis in Graphics*, BBC NEWS, http://news.bbc.co.uk/2/hi/business/7073131.stm (last updated Nov. 21, 2007).

10. *Id*.

11. *Id*.

12. *Id*.

13. OFFICE OF THE COMPTROLLER OF THE CURRENCY, BD. OF GOVERNORS OF THE FED. RESERVE SYS., FDIC & OFFICE OF THRIFT SUPERVISION, EXPANDED GUIDANCE FOR SUBPRIME LENDING PROGRAMS 2 (2001).

14. *See* Edward M. Gramlich, Governor, Fed. Reserve Bd., Remarks by Governor Edward M. Gramlich at the Federal Reserve Bank of Philadelphia (Dec. 6, 2000) ("It is important that the distinction between the generally beneficial subprime market and destructive predatory lending be kept clear.").

ties to attain homeownership, but with rates that jump up after a set period of time.[15]

Before the rise of collateralized debt obligations (CDOs), banks had to carefully screen potential mortgagors before giving out loans, because the banks held onto the risk of default.[16] Credit derivatives, however, were designed to spread that risk around to numerous investors, thereby creating "safer" financial products—at least for the banks that were creating them.[17] In theory, by bundling numerous mortgage loans together, an investor could cover loss on one of those loans by gains on another. With more and more investors seeking out high-yielding (riskier) investments in CDOs, the demand for more subprime mortgages to bundle was high.[18] In 2005, for example, "almost half of all mortgage-linked bonds in America . . . were based on subprime loans," rising from only one tenth of such bonds in 2000.[19] Unfortunately, this system did not take into account what would happen in case of a nationwide housing crash.[20]

By 2005, "one in five mortgages were sub-prime," and these borrowers were the first to default at high rates.[21] This meant almost "1.7 million homes entered foreclosure in 2007" alone, and another 2.2 million followed "in the first three quarters of 2008."[22] This trend continued into 2009 when homeowners with prime mortgages began to default at rates matching and even exceeding the rates of subprime delinquencies.[23] In addition to forcing millions of borrowers to leave their homes and relocate,[24] as foreclosures became more and more prevalent, the number of houses remaining on the market rose, and prices fell dramatically.[25] With falling prices, many homeowners find themselves "unable to sell or re-

15. *The U.S. Subprime Crisis in Graphics*, *supra* note 9. Such subprime loans were also provided to (often working class) families who refinanced. Banks encouraged this option as a way to get cash but often failed to mention what would happen when the rate was "reset." *Id*.

16. *See* GILLIAN TETT, FOOL'S GOLD: HOW THE BOLD DREAM OF A SMALL TRIBE AT J.P. MORGAN WAS CORRUPTED BY WALL STREET GREED AND UNLEASHED A CATASTROPHE 44 (2009).

17. *Id.* at 21.

18. *Id*. at 95 ("Precisely because subprime loans were risky, the home owners who took out such debt typically paid a higher rate of interest than prime borrowers did, and that meant that the 'raw material' of subprime loans produced higher-returning CDOs than those built out of 'prime' mortgages. For returns-hungry investors, subprime-mortgage-based CDOs were gold dust.").

19. *Id*.

20. *Id*. at 96.

21. *The U.S. Subprime Crisis in Graphics*, *supra* note 9; *see All Things Considered: Adjustable-Rate Mortgages Fuel Foreclosure Crisis*, NAT'L PUB. RADIO (Sept. 6, 2007), http://www.npr.org/templates/story/story.php?storyId=14218075 (noting that "[w]hen those [adjustable-rate] mortgages adjust upward, some people are unable to make the payments").

22. Adam J. Levitin, *Resolving the Foreclosure Crisis: Modification of Mortgages in Bankruptcy*, 2009 WIS. L. REV. 565, 566–67.

23. Dina ElBoghdady & Sarah Cohen, *The Growing Foreclosure Crisis*, WASH. POST, Jan. 17, 2009, at A01, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2009/01/16/AR2009011604724.html.

24. Levitin, *supra* note 22, at 568.

25. *See The U.S. Subprime Crisis in Graphics*, *supra* note 9. One Chicago study found that "a single foreclosure depressed neighboring properties' values between $159,000 and $371,000 . . . [which] translates into a single foreclosure costing each of 79 neighbors between $2,012 and $4,696." Levitin, *supra* note 22, at 569.

finance their way out of trouble,"[26] and mortgage lenders are often unable to recover their entire investment through foreclosure sale.[27]

In a slow real estate market, every foreclosure creates real loss in terms of social and economic value. One study in November of 2008 found that investors lose an average of fifty-seven percent of their initial investment for every completed foreclosure.[28] In a 2009 update, that number rose to a 64.65% loss on each foreclosure sale.[29] In addition to losses for lenders, "foreclosures create significant deadweight loss and have major third-party externalities."[30] Particularly in low- to moderate-income communities, foreclosures can produce numerous vacant, abandoned, and blighted buildings.[31] Not only can this have a negative effect on property values and community image, but it can also provide prime targets for vandalism and crime.[32]

As foreclosure filings rose to record levels, evidence of massive lender fraud surfaced.[33] During the rush to create mortgage-backed investments, lenders did not pay much attention to keeping up with their paperwork.[34] This meant that when it came time to start foreclosing on delinquent homeowners, lenders had to find some way to come up with the documentation demonstrating that they truly owned the note—thus the birth of the robo-signing scandal.[35] This problem with documentation arguably caused an "artificial" drop in foreclosure activity as banks put a hold on new filings while they worked out their procedural issues.[36] As a result, even as foreclosure filings decrease, "the severity of the delinquencies is increasing."[37]

B. *Possible Alternatives to Foreclosure*

This Section presents a number of options homeowners may have to avoid foreclosure even when they are unable to make payments as scheduled. Some options are only available to individuals and families

26. ElBoghdady & Cohen, *supra* note 23.
27. Levitin, *supra* note 22, at 568–69.
28. NAT'L CONSUMER LAW CTR., STATE AND LOCAL FORECLOSURE MEDIATION PROGRAMS: CAN THEY SAVE HOMES? 3 (2009) [hereinafter NCLC, CAN THEY SAVE HOMES?].
29. *Id*.
30. Levitin, *supra* note 22, at 568.
31. Immergluck & Smith, *supra* note 7, at 854.
32. *Id*.
33. *See* Tami Luhby, *Foreclosure Fiasco: I Was a Robo-Signer*, CNNMONEY (Oct. 28, 2010, 8:47 PM), http://www.money.cnn.com/2010/10/28/real_estate/robosigner/index.htm?iid=EL.
34. *60 Minutes: Mortgage Paperwork Mess: Next Housing Shock?* (CBS News television broadcast Apr. 3, 2011), *available at* http://www.cbsnews.com/video/watch/?id=7361572n.
35. In the rush to bundle and securitize mortgages and increase profits, many big lenders "cut corners" and skipped much of the paperwork involved. When borrowers began defaulting in high numbers and lenders needed proof they owned the mortgages in order to default, some resorted to "forgery and phony paperwork." *Id*.; *see also* Luhby, *supra* note 33 (explaining the problems associated with the robo-signing scandal).
36. Les Christie, *Foreclosures Off 30% This Year*, CNNMONEY (Apr. 14, 2011, 5:27 AM), http://money.cnn.com/2011/04/14/real_estate/foreclosures_first_quarter_2011/index.htm.
37. *Id*.

with relatively minor financial setbacks, while others might be available to a broader range of homeowners. Although each option has its benefits, the drawbacks and problems in implementation suggest that some form of mediation may still be necessary to realize the benefits of these various options.

1. Options to Keep the Home

When a homeowner falls behind on his or her payments, there are a number of potentially available options to retain possession of the home. The availability of these options is contingent on a number of factors, including the reason for default or delinquency and lender confidence in future payments.[38] The main foreclosure alternatives that allow a homeowner to retain possession typically require negotiations with the loan servicer.[39] With a lender agreement, a borrower may be able to work out a short-term repayment plan, forbearance, refinancing agreement, loan modification, or partial or advance claim.[40]

Typically, a lender will first attempt to negotiate a short-term repayment plan in which the borrower agrees to pay a portion of the delinquency on top of full payments each month for a 90- to 120-day period.[41] This type of solution is usually only viable for delinquent borrowers who are not in "serious financial distress."[42] Such distress is not confined solely to individuals and families in lower income groups[43] and may present itself in a number of objectively visible ways.[44] If a repayment plan will not work, for example, because the individual displays signs of financial distress, a lender might agree to a forbearance period during which the borrower must become current or face foreclosure.[45] This option is best for borrowers who have good past payment histories (aside from the current default) and who can demonstrate that, with time to catch up, they will be able to make full monthly payments and repay the delinquency.[46]

In some situations, mortgage payments are not affordable because of the interest rate. In such cases, the ideal solution could be to refinance the loan.[47] A refinancing agreement can be made with the original lender

38. *See Overview of Alternatives to Foreclosure*, CMTY. HOUS. RES. CTR., http://www.homecen.org/pdf/Overview_of_Alternatives_to_Foreclosure.pdf (last visited Mar. 31, 2013).

39. *Id*.

40. *Id*.

41. *Id*.

42. *Id*.

43. E. THOMAS GARMAN ET AL., FINANCIAL DISTRESS AMONG AMERICAN WORKERS 4 (2005).

44. The Marine Corps Community Services organization provided a list of ten indicia of financial distress in a Marine, but it appears to be applicable to a broader group of Americans. The list includes problems such as trouble meeting "essential financial needs . . . , [r]epeated borrowing from friends and co-workers[,] [n]otifications of bounced checks . . . [and] [r]epeated use of advanced pay." *Financial Problems*, LEADERS' GUIDE FOR MANAGING MARINES IN DISTRESS, http://www.usmc-mccs.org/leadersguide/Personal/Financial/findistress.htm (last visited Apr. 1, 2013).

45. *Overview of Alternatives to Foreclosure*, *supra* note 38.

46. *Id*.

47. *Id*.

or a different lender, can provide a lower or fixed interest rate, and may result in lower monthly payments.[48] Refinancing may be the right solution for borrowers whose credit scores have improved since the original loan application, homeowners whose mortgages were granted when interest rates were higher, or homeowners with adjustable rate mortgages who are worried about impending interest rate increases.[49]

When loan payments become too much for a homeowner to handle, loan modification may be a viable alternative. According to the United States Department of Housing and Urban Development (HUD), "[a] Loan Modification is a permanent change in one or more of the terms of a Borrower's loan."[50] A loan servicer may lower monthly payments by reducing the interest rate, extending the repayment term, or reducing the remaining principal balance.[51] The federal government incorporated into its program loan modifications designed to reduce the number of unnecessary foreclosures, and many foreclosure mediation programs focus on facilitating modifications as well.[52]

Finally, a delinquent borrower may qualify for an interest-free loan from HUD in exchange for a lien on the property.[53] To qualify, the borrower must be at least four months behind in payments but with the capacity to begin making full payments, and the property cannot be in foreclosure.[54] For a qualifying homeowner, this loan will provide the funds needed to become current on a delinquent loan, including any legal fees or costs associated with a foreclosure.[55] As an added benefit, the lender is required to waive any accrued late fees when a partial claim is granted.[56] This option is best for homeowners who have fallen behind in their payments but who would be able to make full payments but for the burden of the delinquency amount, as it essentially transfers the delinquency debt to HUD with no expectation of payment until the first mortgage is paid off or the borrower no longer owns the home.[57]

48. *Id*.

49. BD. OF GOVERNORS OF THE FED. RESERVE SYS., THE FED. RESERVE BD., A CONSUMER'S GUIDE TO MORTGAGE REFINANCINGS 1, 3–5 (Aug. 27, 2008), *available at* http://www.federalreserve.gov/pubs/refinancings/refinancing.pdf.

50. *Loan Modification Frequently Asked Questions*, U.S. DEP'T OF HOUS. & URBAN DEV., http://www.hud.gov/offices/hsg/sfh/nsc/faqlm.cfm (last visited Apr. 1, 2013).

51. *Overview of Alternatives to Foreclosure*, *supra* note 38.

52. *See infra* notes 115–30 and accompanying text (discussing the Home Affordable Modification Program); *see also infra* note 137 and accompanying text.

53. *Overview of Alternatives to Foreclosure*, *supra* note 38.

54. *Id*.

55. *Partial Claim Frequently Asked Questions*, U.S. DEP'T OF HOUS. & URBAN DEV., http://portal.hud.gov/hudportal/HUD?src=/program_offices/housing/sfh/nsc/faqpc (last visited Apr. 1, 2013).

56. *Id.*

57. *Id.*

2. *Options to Exit Gracefully*

For many borrowers, keeping the home is simply not a realistic option.[58] Typically, options designed to preserve homeownership do not work because "borrowers are unemployed or underemployed or have credit problems that go well beyond their mortgage troubles."[59] For some borrowers, the best solution will be to walk away from the mortgage. This option, also referred to as "strategic default," does have consequences, especially financial ones, and is not a decision that should be made lightly.[60] The main consequence for borrowers is a drop in their credit ratings, which can lead to difficulty down the road when seeking new credit extensions.[61] It appears, however, that credit scores can begin to rebound within months of the end of the foreclosure process.[62] Another important consideration will depend on the state where the home is located. In some states, creditors are allowed to recover any difference between the amount due on the loan and the amount recovered at a foreclosure sale directly from the borrower.[63] Some states, called "non-recourse" or "anti-deficiency" states, disallow that practice.[64] As of October 2011, however, most states still allow deficiency judgments.[65] Thus, where a borrower owes more than the value of the home, it is important to consider the possibility of a deficiency judgment before deciding to walk away.[66]

When a strategic default is not in the best interest of the borrower, there are other possible options that fall into the broad category of "graceful exit" options. A graceful exit occurs when the homeowner works out an agreement with the lender to terminate ownership without

58. Jean Braucher, *Humpty Dumpty and the Foreclosure Crisis: Lessons from the Lackluster First Year of the Home Affordable Modification Program (HAMP)*, 52 ARIZ. L. REV. 727, 741 (2010).

59. Ruth Simon, *Banks Ramp Up Foreclosures: Increase Poses Threat to Home Prices; Delinquent Borrowers Face New Scrutiny*, WALL ST. J., Apr. 15, 2009, at A12.

60. Tess Vigeland, *They Walked Away, and They're Glad They Did*, N.Y. TIMES, Nov. 9, 2011, at F9.

61. Brad Tuttle, *After Walking Away From a Mortgage, No Regrets—Not Many Consequences Either*, TIME (Nov. 9, 2011), http://business.time.com/2011/11/09/after-walking-away-from-a-mortgage-no-regrets-not-many-consequences-either/.

62. *Id*.

63. Augustine Diji, *What is the Difference Between Non-Recourse & Recourse States?*, STRATEGIC DEFAULT MONITOR (Feb. 23, 2010, 9:28 PM), http://www.strategicdefault.org/2010/02/what-is-difference-between-non-recourse.html.

64. *Id.*

65. Jessica Silver-Greenberg, *House Is Gone but Debt Lives On*, WALL ST. J. (Oct.1, 2011), http://online.wsj.com/article/SB10001424053111904060604576572532029526792.html.

66. At least one website advises homeowners on when and why to walk away from "underwater" mortgages. *See, e.g.*, *Strategic Default*, YOUWALKAWAY.COM, http://www.youwalkaway.com/strategic-default (last visited Apr. 2, 2013). Today, fear of a deficiency judgment may be even less of a bar to strategic default as some states and localities have unofficially become antideficiency states. For example, although deficiency judgments are allowed in Illinois if requested by the lender in the complaint, such judgments are rarely being entered when the property in question is the borrower's primary residence. *Foreclosure and Deficiency Judgments*, ILL. L. NEWS (Jan. 16, 2010), http://www.illinoislawnews.net/?p=360.

resorting to foreclosure.[67] These options can be better for the borrower's credit and can help reduce or eliminate any potential deficiencies.[68] Such options can also be better for the neighboring community, as they may be able to "help to preserve the condition of the property and prevent blight."[69] Graceful exit options include short sales, deeds-in-lieu, and cash-for-keys agreements.[70]

Because many homeowners bought property during the real estate boom when prices were high, the current sale price for such properties is often insufficient to cover the entire mortgage amount.[71] In these situations, where the mortgage is "underwater,"[72] the borrower may seek a short sale in which the property is sold at its market value (or as close as possible).[73] For such sales, the lender must approve the price, and investors may sometimes require that the price be at least ninety-five percent of the fair market value.[74] The goal of the short sale is to minimize residual debt and avoid the high costs (in terms of both time and money) of a foreclosure.[75] When a short sale is approved, the borrower may be able to reach an agreement with the lender that any deficiency will be forgiven.[76]

One downside to the short sale, however, is the possibility that the borrower will face adverse tax consequences. Under the rules of the Internal Revenue Service, any portion of a debt that is forgiven by the lender may constitute taxable income.[77] The Mortgage Foreclosure Debt Relief Act of 2007 (recently extended at least through 2013)[78] "allows taxpayers to exclude income from the discharge of debt on their principal residence."[79] Another common problem with a short sale, even where it may be the best option for the borrower, is that lender approval is often difficult to obtain if the sale price leaves a significant portion of the loan unpaid.[80] Making the approval process more complicated, a short sale may not be in the best interest of the lender for two main reasons. First,

67. *Glossary*, FORECLOSURE-RESPONSE.ORG, http://www.foreclosure-response.org/glossary.html (last visited Apr. 2, 2013).

68. *Id*.

69. *Id*.

70. *Id.*

71. *See, e.g.*, Vigeland, *supra* note 60, at F9.

72. Ben S. Bernanke, Chairman, Bd. of Governors of the Fed. Reserve Sys., Mortgage Delinquencies and Foreclosures (May 5, 2008) [hereinafter Bernanke Speech], *available at* http://www.federalreserve.gov/newsevents/speech/bernanke20080505a.htm.

73. *Overview of Alternatives to Foreclosure*, *supra* note 38.

74. *Id*.

75. *Glossary*, *supra* note 67.

76. Braucher, *supra* note 58, at 741.

77. *The Mortgage Forgiveness Debt Relief Act and Debt Cancellation*, INTERNAL REVENUE SERV. [hereinafter *Debt Relief Act*], http://www.irs.gov/Individuals/The-Mortgage-Forgiveness-Debt-Relief-Act-and-Debt-Cancellation- (last updated Aug. 3, 2012).

78. Nancy Anderson, *Extension of Mortgage Debt Relief and Debt Cancellation: Options If Your Mortgage Is Still Underwater*, FORBES (Jan. 10, 2013, 9:32 AM), http://www.forbes.com/sites/financialfinesse/2013/01/10/extension-of-mortgage-debt-relief-and-debt-cancellation-options-if-your-mortgage-is-still-underwater.

79. *Debt Relief Act*, *supra* note 77.

80. *See* Elizabeth Razzi, *Where Short Sales Stumble*, WASH. POST, June 15, 2008, at F5.

because the borrower will have the deficiency forgiven in the process, there is less incentive to hold out for a higher sale price and a greater incentive to sell the house as quickly as possible, leading to greater losses for the lender.[81] Second, because of the securitization of the mortgage industry, the original lender may not consider loss mitigation worthwhile if the investor bears the risk of loss rather than the bank.[82]

Another "graceful exit" option is the deed in lieu of foreclosure. In this type of transfer, the borrower essentially trades the home for the debt—the lender gets the home, and the borrower's debt is cancelled.[83] The main benefit for the lender is that a deed-in-lieu will get the borrower out of the home more quickly and cheaply than a foreclosure.[84] Unlike a short sale, however, the lender sees no immediate monetary gain from granting a deed-in-lieu, and as such, a short sale will typically be attempted first.[85] A related option the borrower and lender can consider is the deed-for-lease. Like a deed-in-lieu, a deed-for-lease provides for the lender to take title to the property.[86] In exchange, the borrower gets a term lease in which he or she makes monthly rent payments and is allowed to remain on the premises.[87] From a judicial viewpoint, these solutions are good public policy because they "reduce[] the use of already scarce judicial resources."[88]

Finally, some homeowners may be able to negotiate with their lenders to reach a cash-for-keys agreement. In such agreements, the homeowner is required to leave the home by a certain date, and in exchange, the lender offers a cash payment as incentive.[89] The payment will typically be less than the amount that would be required to pursue foreclosure but can be enough to help a homeowner with the expenses associated with finding a new home.[90] This option may be exercised as part of a deed-in-lieu agreement and, like the other graceful exit options, helps to reduce borrower anger toward the banks—thus, cash-for-keys may help lower the incidence of borrower retaliation and vandalism.[91] Each of these options in lieu of foreclosure has the potential to benefit all in-

81. Terrence M. Clauretie & Nasser Daneshvary, *The Optimal Choice for Lenders Facing Defaults: Short Sale, Foreclose, or REO*, 42 J. REAL EST. FIN. & ECON. 504, 520 (2011).

82. *Id.*; *see also* Delaney & Grim, *supra* note 6 (noting that securitization has made negotiating deals on individual loans incredibly difficult and time consuming due to the number of stakeholders involved in each loan).

83. Braucher, *supra* note 58, at 743.

84. Lawrence Kudlow, *Understanding Your Main Options to Foreclosure*, BRYAN ELLIS REAL EST. LETTER (Oct. 27, 2011), http://realestate.bryanellis.com/5446/understanding-your-main-options-to-foreclosure/.

85. *See* Braucher, *supra* note 58, at 743. It is possible with a deed-in-lieu, however, for the lender to hold off on selling the property and benefit from a higher sales price if the market improves.

86. *Glossary*, *supra* note 67.

87. *Id*.

88. Jeffrey B. Steiner & Jason R. Goldstein, *Zombie Loans Raise Hurdles for Deed-in-Lieu Transactions*, N.Y. L.J., July 15, 2009.

89. *Glossary*, *supra* note 67.

90. *See id*.

91. *See* Susanna Kim, *Here's the Keys, and Some Cement Down the Drains*, ABC NEWS (Jan. 18, 2011), http://abcnews.go.com/Business/million-dollar-foreclosed-home-vandalized/story?id=12638936.

volved parties, and for that reason, federal, state, and local governments have adopted laws and policies to discourage lenders from opting for foreclosure before considering alternatives. The next Section addresses these responses.

C. The Responses

As the economic crisis grew more pronounced, federal, state, and local governments took steps in an effort to slow the swell. Because of the numerous negative consequences associated with the foreclosure crisis, policymakers have sought to reduce the number of foreclosures.[92] The federal government has aimed many of its efforts at encouraging lenders to consider loan modifications as a win-win solution.[93] These efforts are outlined in Subsection 1. State and local governments have similarly sought to increase the availability of loan modifications for qualifying homeowners, but they are using a different tool—the foreclosure mediation program.[94] These programs are briefly described in Subsection 2.

1. Federal Response

The first government programs addressing the foreclosure crisis tended to focus on fostering implementation of private modifications.[95] President George W. Bush took the first such steps in the fall of 2007 when he formed the HOPE NOW Alliance, a public-private partnership designed to promote outreach to homeowners facing foreclosure.[96] HOPE NOW included a Homeowner's HOPE Hotline to provide counseling to homeowners facing foreclosure.[97] The HOPE NOW Alliance also included a direct-mail component designed to encourage borrowers to contact their loan servicer or a credit counselor.[98] In theory, encouraging homeowners to contact their lenders and encouraging lenders to work harder at contacting troubled borrowers would remove the barriers to implementation of permanent loan modifications.[99] Although the Alliance releases data on the number of permanent loan modifications as

92. NCLC, CAN THEY SAVE HOMES?, *supra* note 28, at 3.

93. *Id*. at 6.

94. *Id*. at 3.

95. Anna T. Pinedo & Amy Moorhus Baumgardner, *Federal Mortgage Modification and Foreclosure Prevention Efforts*, 41 UCC L.J. 319, 338 (2009).

96. *Id*. at 322.

97. *Id*.

98. Press Release, HOPE NOW, HOPE NOW Alliance Created to Help Distressed Homeowners (Oct. 10, 2007), *available at* http://web.archive.org/web/20121204210700/http://www.fsround.org/hope_now/pdfs/AllianceRelease.pdf.

99. Bernanke Speech, *supra* note 72.

an indication of success, it is unclear how many of these modifications came about *because of* the program.[100]

Congress followed the President's lead in 2008 by passing the Housing and Economic Recovery Act (HERA).[101] HERA includes a number of provisions designed to strengthen the regulation of Federal Home Loan Banks and the so-called government-sponsored enterprises (Fannie Mae and Freddie Mac).[102] One such provision is the creation of the Federal Housing Finance Agency, a regulatory body with "authority to establish capital, management, and risk standards; to enforce its directives through cease and desist orders; to put a regulated entity into receivership; and to review and approve new product offerings."[103] The bill also authorized additional funds for communities most affected by the foreclosure crisis.[104]

The Housing and Economic Recovery Act of 2008 additionally created a HOPE for Homeowners program (H4H).[105] This temporary program was designed to ensure that mortgages were more affordable over an extended period of time and consisted of refinancing (rather than modification) of distressed loans.[106] Through H4H, homeowners have the opportunity to obtain a new, thirty-year fixed rate mortgage insured by the Federal Housing Administration.[107] Despite an optimistic outlook, the program has not been incredibly successful.[108] One possible reason is that participation is voluntary for both lenders and homeowners.[109]

As the economic problems continued, the federal government began to search for more creative means of addressing the foreclosure crisis.[110] In February 2009, the United States Department of the Treasury created the Homeowner Affordability and Stability Plan, comprised of three mortgage-related programs designed in accordance with the administration's Financial Stability Plan.[111]

---

100. *See, e.g.*, Press Release, HOPE NOW, HOPE NOW Completes 4th Year of Operation, Continues to Assist Millions of Struggling Homeowners Nationwide (Jan. 5, 2011), *available at* http://www.hopenow.com/press_release/files/HN%202010%20Recap%20Release_FINAL.pdf.

101. Pinedo & Baumgardner, *supra* note 95, at 322–23.

102. CITIZENS HOUS. & PLANNING ASS'N, SUMMARY OF "HOUSING AND ECONOMIC RECOVERY ACT OF 2008" 1 (2008), *available at* http://www.chapa.org/pdf/h3221final%20summaryJuly282008rev2.pdf.

103. Pinedo & Baumgardner, *supra* note 95, at 323.

104. *Id*.

105. *Id*.

106. *Id*.

107. U.S. DEPT. OF HOUS. & URBAN DEV., BASIC CONSUMER FACTS ABOUT THE HOPE FOR HOMEOWNERS PROGRAM (Apr. 21, 2010) [hereinafter HUD H4H INFO.], http://archives.hud.gov/initiatives/hopeforhomeowners/consumerfactsheet.cfm.

108. *See* Pinedo & Baumgardner, *supra* note 95, at 323 ("Although the government estimated that 400,000 households would benefit from the program, to date, far fewer borrowers have successfully used the program.").

109. *See* HUD H4H INFO., *supra* note 107.

110. *See* Pinedo & Baumgardner, *supra* note 95, at 339.

111. *Id*. at 329. Collectively, these three programs are referred to as Making Home Affordable (MHA). *Id*. at 330.

One component of the Plan, Home Affordable Refinance (HARP), allowed certain borrowers with Fannie Mae or Freddie Mac mortgages to refinance their loans and possibly obtain a lower fixed rate.[112] The program requires homeowners to be current on payments and to not have been significantly late on making payments in the past year.[113] Additionally, they must be able to make the new payments and have a mortgage with a loan-to-value ratio of eighty percent or higher.[114] A second component involved direct governmental support of Freddie Mac and Fannie Mae in order to build consumer confidence.[115]

The third component, and the component most relevant to this Note, is the Home Affordable Modification Program (HAMP). This program launched in 2009, accompanied by detailed guidelines for mortgage modifications, and is set to expire at the end of December 2013, after the extension.[116] Basic eligibility for HAMP requires that the borrowers prove that they "live in their home, owe less than $729,750, and their mortgage payments amount to more than 31 percent of their monthly income."[117] Since its inception, the program has expanded eligibility requirements to allow homeowners struggling with unemployment, second mortgages, or mortgages for which the value of the home is greater than the amount owed.[118]

Under HAMP, qualifying mortgages are reviewed using a Net Present Value (NPV) calculation.[119] Lenders who participate in the program must first apply a series of modification options to a qualifying loan until monthly payments constitute thirty-one percent or less of the household's current gross monthly income.[120] If a qualifying modification is found, the lender determines whether the NPV of that modification would be greater than the NPV of foreclosure (or no modification).[121] If so, the lender must offer the borrower the modification.[122] In theory, the NPV model identifies the situations in which a loan modification will be

112. *Id*. at 330.

113. *Home Affordable Refinance Program* (HARP), MAKING HOME AFFORDABLE.GOV., http://www.makinghomeaffordable.gov/programs/lower-rates/Pages/harp.aspx (last updated Oct. 18, 2012, 4:20 PM).

114. *Id.*

115. Pinedo & Baumgardner, *supra* note 95, at 329.

116. *Home Affordable Refinance Program (HARP)*, *supra* note 113.

117. Arthur Delaney, *Homeowners Protest HAMP: 'It's Just a Scam and the Banks are Getting Everything*,' HUFFINGTON POST (Oct. 26, 2010, 12:57 PM), http://www.huffingtonpost.com/2010/10/26/homeowners-protest-hamp-i_n_773582.html.

118. *Making Home Affordable*, U.S. DEP'T. OF THE TREASURY, http://www.treasury.gov/initiatives/financial-stability/programs/housing-programs/mha/Pages/default.aspx (last visited Apr. 8, 2013).

119. MAKING HOME AFFORDABLE, MAKING HOME AFFORDABLE PROGRAM: HANDBOOK FOR SERVICERS OF NON-GSE MORTGAGES 84 (ver. 3.3, 2011) [hereinafter MHA HANDBOOK], *available at* https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/mhahandbook_33.pdf.

120. NCLC, CAN THEY SAVE HOMES?, *supra* note 28, at 8. According to the National Consumer Law Center, these options, in order, "include the capitalization of arrears, an interest rate reduction in steps to as low as 2%, extension of the loan repayment term, and then forbearance of a portion of the outstanding principal." *Id*.

121. MHA HANDBOOK, *supra* note 119, at 85.

122. *Id*.

both more affordable for borrowers and better (financially) for investors.[123]

The incentives for homeowner participation are clear—HAMP provides struggling borrowers with an opportunity to owe lower monthly payments and the possibility of a principal reduction (at the discretion of the lender or based on good performance under a permanent modification).[124] Despite the economic logic behind modifying rather than foreclosing on mortgages, private modifications have not occurred to a significant extent without the provision of further incentives.[125] To encourage servicers to participate, the program provides a payment of $1000 for each permanent modification reached through HAMP.[126] An additional $500 is given in situations in which the borrower receiving the permanent modification had not defaulted before beginning the trial plan.[127] Another $1000 is granted annually for up to three years to a servicer if the modification resulted in payments reduced by six percent or more, and the borrower remained less than ninety days delinquent.[128] Finally, HAMP provides incentives for investors. For a maximum of five years, investors receive payments equal to one-half of the difference between the homeowner's monthly payments with and without the modification.[129] These incentives are designed to offset the potential for decline in home value during the modification period, as such a decline would make a failed modification more costly than an initial foreclosure.[130]

Despite an optimistic goal of assisting three to four million homeowners to avoid foreclosure, only around 230,000 borrowers received a permanent modification under HAMP in the first year.[131] This number may also be deceptively high, as about 92,000 of those are expected to redefault based on the prevalence of high overall debt burdens.[132] One major problem is a lack of accountability and servicer oversight.[133] Servicers negotiated for greater control over the process, which has allowed them to avoid some of the formal requirements.[134] The failure of many servicers to notify eligible borrowers of the availability of the program means that many homeowners will remain unaware of this potential solu-

123. NCLC, CAN THEY SAVE HOMES?, *supra* note 28, at 8.
124. *See* MHA HANDBOOK, *supra* note 119, at 76–78; OFFICE OF THE SPECIAL INSPECTOR GEN. FOR THE TROUBLED ASSET RELIEF PROGRAM, QUARTERLY REPORT TO CONGRESS 72 (Jan. 26, 2011) [hereinafter SIGTARP, QUARTERLY REPORT].
125. Braucher, *supra* note 58, at 736.
126. SIGTARP, QUARTERLY REPORT, *supra* note 124, at 71.
127. *Id*.
128. *Id*.
129. *Id*. at 72.
130. *Id*.
131. Braucher, *supra* note 58, at 727.
132. *Id*.
133. This section presents some of the more problematic aspects associated with the implementation of HAMP but is by no means an exhaustive list. *See generally id.* (discussing further information). Typical servicer abuses can also be found in the National Consumer Law Center's 2009 report. NCLC, CAN THEY SAVE HOMES?, *supra* note 28, at 9–10.
134. *See* NCLC, CAN THEY SAVE HOMES?, *supra* note 28, at 9.

tion.[135] Additionally, the determination that a borrower is in "imminent default" was left up to the servicer, which further limits the number of borrowers who might benefit from the program.[136] Finally, the NPV test was not originally made public, and no system was put in place to review modification denials under the program.[137] As a result, a servicer can deny modification to a borrower even if that modification has a greater net present value than a foreclosure with no real possibility of repercussions.[138]

2. *The State and Local Response—Mediation Programs*

While recent federal efforts have focused on incentivizing servicers to offer loan modifications instead of simply foreclosing, state and local governments have designed their own systems to encourage alternatives to foreclosure.[139] One popular approach has been the adoption of foreclosure mediation programs.[140] Today, some level of conference or loss mitigation review is required in at least nineteen states (plus the District of Columbia), as well as counties or municipalities in ten other states.[141] These programs range in intensity and extent of requirements, but each, at a minimum, provides for some contact between a servicer and a borrower before resorting to a foreclosure sale.[142] Statutes in some states require only that the lender "certif[y] that its attorney discussed or attempted to discuss loss mitigation options with the borrower."[143] Because there is no requirement for the participation of a neutral third party, this rule essentially gives all of the power to the lender.[144]

Some states, including Connecticut, Maine, Nevada, New York, and Vermont, provide for mandatory mediation proceedings that allow for less lender freedom in terms of compliance.[145] In Nevada, for example, the foreclosure process is conducted out of court, yet homeowners are able to request court-supervised mediation before a foreclosure sale.[146] Neutral mediators approved by the court conduct the mediations, and lenders are required, among other things, to bring certain documents to

135. *See id*.
136. Braucher, *supra* note 58, at 750.
137. NCLC, CAN THEY SAVE HOMES?, *supra* note 28, at 9.
138. *See id*.
139. Geoff Walsh, *The Finger in the Dike: State and Local Laws Combat the Foreclosure Tide*, 44 SUFFOLK U. L. REV. 139, 158–59 (2011).
140. *Id*. at 159.
141. GEOFF WALSH, NAT'L CONSUMER LAW CTR., REBUILDING AMERICA: HOW STATES CAN SAVE MILLIONS OF HOMES THROUGH FORECLOSURE MEDIATION 6 (2012) [hereinafter NCLC, REBUILDING AMERICA]; *see also Foreclosure Mediation Programs by State*, NAT'L CONSUMER LAW CTR., http://www.nclc.org/issues/foreclosure-mediation-programs-by-state.html (last visited Apr. 8, 2013).
142. NCLC, CAN THEY SAVE HOMES?, *supra* note 28, at 1–2.
143. Walsh, *supra* note 139, at 159–60.
144. *See id*. at 160.
145. *Id*.
146. GEOFF WALSH, NAT'L CONSUMER LAW CTR., STATE AND LOCAL FORECLOSURE MEDIATION PROGRAMS: UPDATES AND NEW DEVELOPMENTS 2 (2010).

the session.[147] Although the data is not conclusive, it appears that the program, which went into effect in July 2009, may have been one reason that foreclosure filings fell in Nevada between November 2008 and November 2009.[148]

More recently, the Illinois Supreme Court promulgated rules for judicial circuits looking to implement and administer foreclosure-specific mediation programs.[149] These rules are designed to create consistency between mortgage foreclosure mediation programs in Illinois while "mitigating abuses and uncertainty in mortgage foreclosures[] and helping those who face the loss of their homes . . . ."[150] Under these rules, resources should be provided such that homeowners must have "meaningful access" to any mediation programs, including access to HUD-certified housing counseling and pro bono legal representation.[151] In addition, lenders are required to "comply with the requirements of any loss mitigation program which applies to the subject mortgage loan" before a judgment of foreclosure can be granted.[152] Through these rules, Illinois sets an example of how states can get involved in the foreclosure crisis affecting so many different localities.

III. ANALYSIS

This Part begins, in Section A, with a discussion of the benefits and problems associated with foreclosure mediation programs, including analysis of arguments made by proponents and critics. Assuming that foreclosure mediation is a beneficial program overall, this Part proceeds in Section B to look more specifically at the requirement of good faith participation. Again, there are a number of advantages and disadvantages to this element of a mediation program, each of which is explored in turn. Next, Section C describes examples of what a good faith requirement would look like. Finally, Section D considers what sanctions would be appropriate for failure to participate in good faith.

A. Why Have Foreclosure Mediation Programs?

Proponents of foreclosure mediation programs seem to assume that such programs are the obvious solution to the current crisis.[153] Critics, on the other hand, present a much grimmer view of the programs, suggest-

147. *Id*.

148. *Id*. (noting that foreclosure filings fell in Nevada by thirty-three percent from November 2008 to November 2009, even while national foreclosure filings rose by eighteen percent during that same period).

149. ILL. SUP. CT. R. 99.1 (eff. Mar. 1, 2013).

150. Press Release, Joseph R. Tybor, Dir. of Commc'ns, Supreme Court of Ill., Illinois Supreme Court Adopts New Rules to Ease Burden of Home Foreclosure Process (Feb. 22, 2013), *available at* http://www.state.il.us/court/Media/PressRel/2013/022213.pdf.

151. ILL. SUP. CT. R. 99.1(d)(ii), (iii).

152. ILL. SUP. CT. R. 114(a).

153. *See, e.g.*, NCLC, CAN THEY SAVE HOMES?, *supra* note 28, at 3 ("It is not surprising that foreclosure mediation programs have been an attractive option at the state and local level.").

ing that they are unworkable, at best.[154] This Section presents both sides of the debate and suggests that the flaws identified by the critics are not fatal.

1. Benefits

The principle that foreclosure avoidance methods are desirable is not in debate.[155] Loan modifications like those required by HAMP, however, will not work for every delinquent or at-risk borrower.[156] For some borrowers—including homeowners who are unemployed or have unusually high household expenses—even a modified loan will result in payments that are not affordable.[157] For these borrowers, other foreclosure alternatives such as a short sale or deed-in-lieu may be a more realistic option to avoid future redefault.[158] For others, the only option will be to search for alternate living arrangements during the foreclosure process.

No matter which potential solution will be best for a particular borrower, the foreclosure mediation programs provide a structured setting in which mortgage servicers evaluate a borrower's available options subject to court supervision to ensure compliance.[159] By creating this forum to encourage lenders to consider alternatives to foreclosure, overall financial losses on defaulted loans can be minimized.[160] Another advantage of a properly designed and implemented mediation program is that it should prevent foreclosure when it is not in the best financial interests of the parties but would not require servicers to renegotiate loans for borrowers who could not afford payments even where the terms were most favorable to the homeowner.[161] Finally, as in any other setting, alternative dispute resolution (ADR) has the potential to provide benefits such as conservation of judicial resources and the promotion of "[a]ssisted-dialogue, cooperative (collaborate) problem solving, . . . empowerment, flexibility and beneficial solutions."[162]

A well-functioning foreclosure mediation program is likely to benefit other parties as well. Because of the structure of many large lending

154. *See, e.g.*, *U.S. Home Foreclosure Mediation in Jeopardy—Report*, REUTERS (Sept. 23, 2009, 1:50 PM), http://www.reuters.com/article/2009/09/23/usa-housing-foreclosures-idUSN2340194220090923.

155. *See, e.g.*, AM. SECURITIZATION FORUM, STATEMENT OF PRINCIPLES, RECOMMENDATIONS AND GUIDELINES FOR A STREAMLINED FORECLOSURE AND LOSS AVOIDANCE FRAMEWORK FOR SECURITIZED SUBPRIME ADJUSTABLE RATE MORTGAGE LOANS 1 (2008) ("[T]he interests of secondary mortgage market participants continue to be aligned with borrowers, communities and policymakers to prevent foreclosures where possible.").

156. *See* Braucher, *supra* note 58, at 741.

157. *Id*.

158. *Id*. at 743.

159. Walsh, *supra* note 139, at 159.

160. *See* NCLC, CAN THEY SAVE HOMES?, *supra* note 28, at 3.

161. *See id*. (stating that foreclosure mediation programs have "great potential to promote rational conduct as an alternative to massive destruction of value"); *see also* Eric A. Posner & Luigi Zingales, *A Loan Modification Approach to the Housing Crisis*, 11 AM. L. & ECON. REV. 575, 584 (2009).

162. Kimberlee K. Kovach, *Good Faith in Mediation—Requested, Recommended, or Required? A New Ethic*, 38 S. TEX. L. REV. 575, 591 (1997).

organizations, it is often too costly to work individually with homeowners to work out a solution that benefits all relevant parties.[163] Additionally, the securitization of mortgage loans means that the party dealing with the borrower no longer has the financial incentives to maximize the recovery on the loan.[164] This incentive-structure problem can be remedied by requiring mortgage servicers to seriously consider foreclosure alternatives or face costly sanctions. If banks are required to work with homeowners in a structured program with court oversight, there is a better chance the parties will reach a solution that benefits homeowners and investors, as well as the broader community.[165]

2. *Problems*

Despite the laudable goals of foreclosure mediation programs and the hope they provide to many struggling homeowners, a number of general criticisms have arisen. For example, without some kind of oversight, the programs essentially allow the lender to ignore the required considerations and proceed to foreclosure even when it will result in greater financial loss.[166] Even where such programs do promote loan modifications over foreclosure, there is a "tendency of many loan modifications to increase the homeowner's monthly payment," which can result in high redefault rates, as well as homeowner frustration.[167] Finally, there is some worry that an emphasis on state and local response in the form of foreclosure mediation programs will serve to minimize the need for federal response and statutory changes.[168]

Although these problems may seem daunting, they do not indicate that mediation programs should not be attempted. Instead, they suggest certain considerations that must be taken into account when designing a mediation program. For example, the problem with a lack of oversight can be addressed by encouraging courts to order meaningful sanctions for failure to mediate in good faith (e.g., by not attending mediation with authority to agree to a loan modification). If lenders fear sanctions, they will be more inclined to seriously consider alternatives to foreclosure where viable, resulting in fewer loss-producing foreclosures.[169] Sanctions will also begin to resolve the problem of loan modifications that increase

163. *See* Olga Pierce & Paul Kiel, *Loan Mod Program Left Homeowners' Fate in Hands of Dysfunctional Industry*, PROPUBLICA (Feb. 17, 2011, 5:03 PM), http://www.propublica.org/article/loan-mod-program-left-homeowners-fate-in-hands-of-dysfunctional-industry.

164. *Id.* ("[M]ortgage servicers . . . don't own the vast majority of the loans they handle. So, they don't bear the loss if the loan goes to foreclosure. In fact, servicers often make money from foreclosure fees.").

165. *See supra* notes 28–32 and accompanying text (discussing the various problems associated with a high foreclosure rate).

166. *See, e.g.*, *supra* note 138 and accompanying text.

167. NCLC, CAN THEY SAVE HOMES?, *supra* note 28, at 6.

168. *Id.*

169. *See U.S. Home Foreclosure Mediation in Jeopardy—Report*, *supra* note 154 (noting the need for greater accountability before foreclosure mediation programs can be successful).

monthly payments for the homeowner.[170] Sanctions ensure not only that lenders will be required to offer more realistic modifications to homeowners, but homeowners will be required to consider graceful exit alternatives when staying in the home is not a viable option.[171]

The final concern—that focus on mediation programs will detract attention from broad national attempts to ameliorate the foreclosure problem—is less likely to be resolved by a good mediation program. Because the foreclosure crisis is continuing and has spread into other areas of the United States economy, it is unlikely that policy makers will assume that a mediation program will solve the underlying economic problems. This is particularly true because mediation programs only purport to address the problem retrospectively. There are already an overwhelming number of foreclosure cases in the courts, and mediation programs are designed to lessen the burden on courts and encourage economically efficient solutions.[172] The need for national policies addressing the root of the foreclosure crisis is still pressing, and policy makers must keep this fact in mind.

B. Why Have a Good Faith Requirement?

1. Goals and Proponents

When designing a program in response to the foreclosure crisis, a number of considerations must be taken into account. First, the prevalence of lender misconduct is higher now in this current crisis, at least in part because of lender shortcuts and other bad practices made common while credit was readily available.[173] Lenders have significant power in the foreclosure setting, and stories of borrowers being strung along by their mortgage lenders abound.[174] Thus, a successful program will have to account for this tendency. Second, there are some borrowers who are not interested in anything more than delaying the bank's ultimate acquisition of the property.[175] If such practice is allowed to continue unchecked, lenders may become frustrated and less inclined to participate at all.

Another major problem associated with current foreclosure practices arises because lenders have an overwhelming power advantage when

170. *See infra* notes 227–29 and accompanying text.

171. *See infra* note 328 and accompanying text.

172. *See* TIMOTHY C. EVANS & MOSHE JACOBIUS, CIR. CT. OF COOK CNTY., CHANCERY DIVISION MORTGAGE FORECLOSURE MEDIATION PROGRAM: PROGRESS REPORT 5–7 (2012) (explaining the problem of foreclosure in Cook County, Illinois, and the goals of the foreclosure mediation program).

173. *See* Walsh, *supra* note 139, at 157–58.

174. *See id*. at 158; *see also CitiMortgage: Consumer Complaints & Reviews*, CONSUMERAFFAIRS, http://www.consumeraffairs.com/finance/citi_mortgage.html (last visited Apr. 8, 2013).

175. *See* David Streitfeld, *Owners Stop Paying Mortgage . . . and Stop Fretting About It*, N.Y. TIMES, June 1, 2010, at A1.

it comes to modifications.[176] The main reason for the imbalance is that lenders have successfully lobbied to keep the NPV formula secret as proprietary information.[177] As a result, lenders with no intention of reaching a settlement with the borrower can claim failure of NPV—regardless of the actual outcome of the calculation.[178]

These problems can be addressed by implementing a good faith requirement for all involved parties. In conjunction with the availability of court-imposed sanctions for failure to comply, a good faith requirement has the potential to increase accountability of all parties and thereby increase the likelihood of reaching agreement on a foreclosure alternative.[179] If lenders know that they can no longer falsely claim failure of NPV calculations without being sanctioned, they will have greater incentive to negotiate honestly. Greater lender honesty means that more homeowners will know whether they qualify for a loan modification (and if not, why they do not qualify). Additionally, those homeowners who do qualify will be more likely to obtain a loan modification, resulting in fewer foreclosures and therefore less loss to investors.[180] Finally, those homeowners who are not able to modify their loans will likely be somewhat more content if they at least understand why the banks cannot agree to a modification.[181]

Beyond these specific benefits, a well-defined, objective good faith mediation requirement will have three main advantages. First, all of the relevant parties will face less uncertainty in terms of what steps they need to take to comply with the law.[182] Second, the standard will be easier for courts to enforce because behavior falling afoul of the rule will be clear and objectively determinable.[183] Finally, the rule will likely be the subject of significantly less litigation because violations will be more readily discernible to reviewing bodies.[184] Each of these benefits can, in turn, en-

176. Ilyce Glink, *Foreclosure Mediation Programs Aren't Working Because of Net Present Value (NPV) Calculations*, CBS MONEYWATCH (Sept. 23, 2009, 5:29 PM), http://www.cbsnews.com/8301-505145_162-37141067/foreclosure-mediation-programs-arent-working-because-of-net-present-value-npv-calculations/.

177. NCLC, CAN THEY SAVE HOMES?, *supra* note 28, at 9.

178. *Id.*

179. *Id.*

180. *See* EVANS & JACOBIUS, *supra* note 172, at 16 (reporting a 300% increase in the number of cases reaching an agreement with the bank from the first year of the program to the second); *see also supra* notes 27–29 and accompanying text.

181. *See* EVANS & JACOBIUS, *supra* note 172, at 8.

182. *See, e.g.*, Jesse D. Stewart, *Maine's Foreclosure Mediation Program: What Should Constitute a Good Faith Effort to Mediate?*, 64 ME. L. REV. 249, 281 (2011).

183. Several authors refer to this benefit of an objective good faith requirement as giving foreclosure mediation "teeth." *See, e.g.*, Jennifer Ngai Lavallee, Legal Aid Soc'y of D.C., Testimony to the Committee on Public Services and Consumer Affairs, Council of the District of Columbia on Bill 19-676: Saving DC Homes from Foreclosure Clarification Amendment Act of 2012, at 5 (June 28, 2012), *available at* http://www.legalaiddc.org/issues/documents/2012%20Legal%20Aid%20Testimony%20on%20Foreclosure%20Mediation%20Law.pdf.

184. *See* David S. Winston, *Participation Standards in Mandatory Mediation Statutes: "You Can Lead a Horse to Water. . . ."*, 11 OHIO ST. J. ON DISP. RESOL. 187, 203 (1996).

hance the perceived and actual integrity of the mediation program as a whole.

2. *Criticisms*

Not everyone is so enamored with the possibilities presented by good faith requirements in mediation.[185] In 2005, one critic raised four basic reasons why a broad good faith requirement should not be adopted for mediations.[186] In addition, as a general matter, this critic objects to the analogy between good faith in mediation and good faith in labor negotiations.[187] The first specific criticism is that there is no clear definition of good faith that can be applied consistently.[188] Thus, the application of a good faith requirement can vary from jurisdiction to jurisdiction and even from judge to judge. Additionally, without clear standards, one party could effectively block any possibility of negotiating an agreeable outcome by, for example, refusing to consider anything but its initial stance set out before mediation.[189] In such cases, mediation becomes futile and serves merely to waste precious time and resources of the parties and the court.

Second, good faith is often interpreted to require that the parties send someone to the mediation who has authority to agree to a settlement, yet "sufficient settlement authority" can be difficult to discern.[190] This is particularly true if the judge does not have in-depth knowledge of the details of a case.[191] Additionally, a party could easily evade this requirement by privately instructing representatives not to settle while officially giving them authority to do so.[192] Finally, the costs associated with getting someone with settlement authority to attend the mediation can be very high, particularly if, as is often the case with banks, that person may be difficult to reach or schedule.[193]

A third concern raised by critics is that enforcing good faith participation in mediation constitutes excessive court intrusion into a process that is intended to be highly confidential.[194] In order for a good faith requirement to be successful, someone involved in or present at the mediation would have to be the whistle-blower, potentially violating confidentiality provisions.[195] This conflict of interest is particularly problematic

185. *See, e.g.*, John Lande, *Why a Good-Faith Requirement Is a Bad Idea for Mediation*, 23 ALTERNATIVES TO HIGH COST LITIG. 1 (2005).

186. *Id*. at 2–5.

187. *Id*. at 3–4.

188. *Id*. at 2.

189. Winston, *supra* note 184, at 193–94.

190. Lande, *supra* note 185, at 2.

191. *Id*. at 2–3.

192. *Id*. at 3.

193. *See, e.g.*, CTR. FOR N.Y.C. NEIGHBORHOODS, LOCKED OUT: LITTLE RELIEF FOR NYC HOMEOWNERS IN THE FORECLOSURE SETTLEMENT PROCESS 1 (2009), *available at* http://www.nclc.org/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/ny_locked_out_report.pdf.

194. Lande, *supra* note 185, at 3.

195. *Id*.

when courts and parties are not certain of what, exactly, constitutes good faith participation.[196] In such situations, a court may require some testimony from a supposedly impartial observer in order to ascertain exactly what happened during the negotiations.[197] Putting the mediator in the position of informing a judge about party misbehavior has the potential to destroy the neutrality that is essential to the perception of fairness.[198]

Finally, a vague good faith requirement will not prevent "savvy participants" from "tak[ing] inappropriate advantage of mediation."[199] According to this argument, parties who intend to engage in bad faith negotiations will find ways around a good faith requirement.[200] This problem is exacerbated in the foreclosure mediation setting because investors often place restrictions on a servicer's ability to modify loans.

> Typical restrictions . . . may include a cap on the number of mortgages that may be modified, requiring a default on the mortgage loan to be 'reasonably foreseeable' before modification is permitted, mandating approval by the owners of the mortgage-backed securities for certain actions and imposing a general obligation to act only in a manner beneficial to the security holders.[201]

To make modifications even more difficult, these restrictions are often read and interpreted very narrowly by servicers to avoid the possibility of litigation and liability for any losses.[202]

Because of these problems, opponents of the good faith requirement believe that the requirement has the potential to undermine the interests of all of the involved parties and detract from overall confidence in mediation as a viable alternative to litigation.[203] Instead, the argument is that where there is no evidence of a high incidence of bad faith behavior, "[s]anctions should be imposed only for violations of rules specifying objectively-determinable conduct."[204] Under this view, however, good faith need not be completely removed from mediation proceedings. The power structure of mortgage foreclosures and the prevalence of "bad" behavior by banks and homeowners alike suggest that the need for sanctions for failure to mediate in good faith is more acute than in, for exam-

196. *See* Winston, *supra* note 184, at 200–01.

197. *See* Alexandria Zylstra, *The Road from Voluntary Mediation to Mandatory Good Faith Requirements: A Road Best Left Untraveled*, 17 AM. ACAD. MATRIMONIAL LAW 69, 95–96 (2001).

198. *See* Andrea Kupfer Schneider & Natalie C. Fleury, *There's No Place Like Home: Applying Dispute Systems Design Theory to Create a Foreclosure Mediation System*, 11 NEV. L.J. 368, 383–84 (2011): Zylstra, *supra* note 197, at 94–97.

199. Lande, *supra* note 185, at 4.

200. *Id*.

201. Pinedo & Baumgardner, *supra* note 95, at 321. Note that requiring default to be "reasonably foreseeable" will not pose a problem in the mediation context as the homeowners in foreclosure have, by definition, already defaulted.

202. *Id*.

203. Lande, *supra* note 185, at 4–6.

204. *Resolution on Good Faith Requirements for Mediators and Mediation Advocates in Court-Mandated Mediation Programs*, 2004 A.B.A. SEC. DISP. RESOL. 1, 2; *see also* Lande, *supra* note 185, at 4–5.

ple, a mediation between corporations with bargaining powers that are closer to equal.[205]

The need for a good faith requirement does not, however, make the criticisms of "good faith" irrelevant. Instead, the key to developing a successful foreclosure mediation program while incorporating a good faith requirement is to define the conduct that constitutes good faith in concrete, objective terms in order to reduce uncertainty, ambiguity, and the need for mediator testimony. There may always be parties that do not wish to accept settlement, and traditional judicial remedies will remain available in those cases. That mediation may not be right for all parties does not suggest that it cannot be meaningfully utilized by others.

C. The Good Faith Requirement

Although a requirement of good faith appears in a number of settings, particularly those related to mediation programs, the term is rarely defined.[206] One definition is found in the Uniform Commercial Code, which defines good faith as "honesty in fact and the observance of reasonable commercial standards of fair dealing."[207] Similarly, *Black's Law Dictionary* defines good faith as "[a] state of mind consisting in (1) honesty in belief or purpose, (2) faithfulness to one's duty or obligation, (3) observance of reasonable commercial standards of fair dealing in a given trade or business, or (4) absence of intent to defraud or to seek unconscionable advantage."[208] Without further explication, however, these definitions provide only limited usefulness for a court, particularly because the exact interpretation will be highly context specific.[209] Thus, in the context of mediation, the definition must require behaviors that further the basic purposes of the program.[210]

In the broader context of mandatory mediation programs, one scholar has suggested that the key to the success of such programs lies in identifying objective participation standards that "provide a clear and enforceable definition of the participation necessary to constitute compliance."[211] According to this model, a party satisfies the requirements of the standard so long as a party representative with authority to make proposals and settle disputes attends the mediation and the representative engages in "minimal preparation" before the conference.[212] One example of minimal preparation is a requirement that both parties submit a document summarizing their positions on the various issues.[213] In the context of foreclosure mediation, the parties' positions may be relatively

205. *See supra* notes 166–71 and accompanying text.
206. Lande, *supra* note 185, at 1.
207. U.C.C. § 1-201(b)(20) (2010).
208. BLACK'S LAW DICTIONARY 762 (9th ed. 2009).
209. RESTATEMENT (SECOND) OF CONTRACTS § 205(a) (1981).
210. *See supra* Part III.B.1.
211. Winston, *supra* note 184, at 201.
212. *Id*. at 201–02.
213. *Id*. at 202.

straightforward, and a document outlining those positions could be insufficient to ensure meaningful participation at the mediation. While the parties should not be required to agree to a settlement at mediation, a well-defined good faith requirement has the potential to encourage more servicers to consider alternatives to foreclosure where it is in the best interests of all involved parties.

1. Categories of Good Faith

a. A Party with Settlement Authority Attends Mediation

When a party does not attend mediation or sends a representative without full authority to settle, the mediation process is severely undermined. Instead of providing an opportunity for the parties to discuss the possibility of reaching a mutually acceptable agreement, delay ensues, and mediation costs can pile up.[214] Many borrowers complain that a major problem in attempting to work with banks outside of mediation is that it is difficult to reach someone who knows anything about their case, let alone who has the authority to propose or accept an agreeable solution.[215] Additionally, if the lender cannot accept or reject a proposal during mediation and the process drags out longer, the homeowners remain in limbo—waiting for the bank to make a decision about their modification while interest continues to accrue.[216]

On the other hand, complete settlement authority can be extremely difficult to provide in the foreclosure mediation setting. Because mortgages were securitized and sold to investors, there are more interested parties, meaning more coordination is required. Not only must the higher-ups at the bank be available to sign off on any agreement, but investors must often be consulted as well.[217] The difficulty faced in ensuring all parties required to settle a matter are present at mediation becomes more complex still when one considers the number of foreclosures and mediations that are currently ongoing. Not only do these essential bank and investor representatives have to appear at the mediation of Henry Homeowner, but they must also be available to approve any negotiated deal with all other homeowners whose loans their bank services. With the big banks, this challenge may simply be impossible to meet.

214. *See* Don Peters, *Just Say No: Minimizing Limited Authority Negotiating in Court-Mandated Mediation*, 8 PEPP. DISP. RESOL. L.J. 273, 273–74 (2008) (noting some of the problems associated with mediation between parties with limited authority).

215. *See, e.g.*, Pierce & Kiel, *supra* note 163 ("The major servicers hired tens of thousands of employees to help handle the flood of phone calls, but the same cost-cutting approach kept pay low. Experience wasn't necessary.").

216. *See* Kevin F. Jursinski, *The Mortgage Foreclosure Crisis in Florida: A 21st Century Solution,* 84 FLA. B. J. 91, 91–92 (2010).

217. *See, e.g.*, Pasillas v. HSBC Bank USA, 255 P.3d 1281, 1283–84 (Nev. 2011) ("[R]espondents stated they would need additional investor approval before agreeing to a loan modification."); *see also supra* notes 16–19 and accompanying text.

b. Parties Provide Documents Necessary for Settlement

Another problem the parties to a foreclosure might have in seeking to work out a mutually acceptable agreement arises when the parties do not have all of the relevant information. Homeowners seeking to modify their loans often find that they have to send in certain documentation repeatedly before lenders will acknowledge receipt.[218] Additionally, the most common reason for modification denial is missing documents.[219] It is unclear whether these denials are a result of lenders losing (or claiming to have lost) documents sent in by homeowners or homeowner failure to submit all the necessary paperwork. Likely, it is some combination of the two. Without certain documentation, including financial information of the homeowner and proof of loan ownership by the servicer, negotiating an agreement is much more difficult, if it is possible at all.

One particularly controversial document-related issue is whether lenders should be required to provide information relating to their analysis of which loans are eligible for modification. The Nevada program requires that lenders provide "Evaluative Methodology used to determine eligibility or no eligibility of the homeowner for a loan modification" or face sanctions.[220] Despite this requirement, it is unclear what "evaluative methodology" actually means.[221] Additionally, the rule provides that the information be provided only to the mediator "under confidential cover," meaning that the homeowner will often remain unclear about the reason a lender will not approve a loan modification.[222] Many lenders demand such confidentiality with regard to decision-making calculations, as they consider the results to be "'proprietary' information."[223] This argument seems moot, however, as these calculations can now be found online for homeowners to conduct themselves.[224] Thus, it seems that the only reason to keep such information private is to hide discrepancies between the true financial information of the borrower and the financial information used by the lender in the calculation.

In some instances, however, requiring that a lender provide loan modification evaluation information may be "an unnecessary obstacle" to initiating mediation.[225] If a homeowner chooses a graceful exit strategy, for example, an NPV calculation would be meaningless. Alternative-

218. Pierce & Kiel, *supra* note 163.

219. *Id*.

220. *Trustees/Lenders*, STATE OF NEV. FORECLOSURE MEDIATION PROGRAM, http://foreclosure.nevadajudiciary.us/index.php/trustees-lenders (last visited Apr. 8, 2013).

221. NCLC, CAN THEY SAVE HOMES?, *supra* note 28, at 11 (internal quotation marks omitted).

222. NEV. SUP. CT. FORECLOSURE MEDIATION R. 11(8); *see also* NCLC, CAN THEY SAVE HOMES?, *supra* note 28, at 11.

223. NCLC, CAN THEY SAVE HOMES?, *supra* note 28, at 9.

224. *See, e.g.*, *Getting Started with CheckMyNPV*, MAKING HOME AFFORDABLE.GOV, http://checkmynpv.com (last visited Apr. 8, 2013).

225. MELANCA CLARK & DANIEL OLMOS, EMERGING STRATEGIES IN FORECLOSURE MEDIATION 105 (2011), *available at* http://www.ncsc.org/sitecore/content/microsites/future-trends-2011/home/Special-Programs/~/media/Microsites/Files/Future%20Trends/Author%20PDFs/Clark%20Olmos.ashx.

ly, where mediation is designed to occur very early on in the foreclosure process, or when the borrower has not provided the requisite documents, the lender cannot be faulted for failing to present their calculations. In such situations, a strict checklist of required documents might inaccurately indicate bad faith unless some mechanism were present to indicate excused failure to provide the documentation.

c. Parties Consider Alternative Proposals

Another frequent complaint from homeowners is that banks attend mediation with only one proposal and refuse to consider any alternative compromises.[226] Often these initial proposals are unrealistic, and "many loan modifications . . . increase the homeowner's monthly payment."[227] Even if a homeowner accepts an unrealistic plan, such a modification is likely to cause quick redefault.[228] The fault in this area cannot lie solely with the lenders, however. In some instances (but not all), lenders are unwilling to propose "realistic" loan modifications because the particular homeowners are not good candidates for modification, and thus there is no modification that is optimal for all parties.[229] Certain homeowners, like those without a steady stream of income, are not well situated to take advantage of a loan modification offered by the lender.[230] In such cases, it is the refusal of the homeowner to consider "graceful exit" alternatives that can lead to an impasse in negotiations.

d. Parties Strictly Comply with Mediation Rules

Each of the previous possibilities for good faith compliance refers to a specific problem affecting the parties to foreclosure mediation. Another option is for courts to find good faith based on compliance with mediation program rules. In *Levya v. National Default Servicing Corp.*,[231] the Nevada Supreme Court held that the statute required strict (and not just substantial) compliance with the program rules because the legislature intended for the language ('shall') to be mandatory.[232] This conception of good faith provides consistency and certainty by outlining clear rules lenders can follow to avoid sanctions. Thus, sanctioning decisions could be more predictable and less arbitrary.

226. *See, e.g.*, Wells Fargo Bank, N.A. v. Hughes, 897 N.Y.S.2d 605, 609–10 (N.Y. Sup. Ct. 2010) (dismissing the bank's foreclosure case against the homeowners and ordering sanctions because Wells Fargo offered an unrealistic initial proposal and refused to revise the terms despite a "Court[] directive" to do so).

227. NCLC, CAN THEY SAVE HOMES?, *supra* note 28, at 6.

228. *Id*.

229. *See* EVANS & JACOBIUS, *supra* note 172, at 7–8 (noting that not every home can be saved, and that a homeowner must have "sufficient income to sustain a permanent modification").

230. *See supra* notes 157–58 and accompanying text.

231. 255 P.3d 1275 (Nev. 2011).

232. *Id*. at 1279.

Criticism of this definition of good faith may come from two different directions. First, homeowners and their supporters may argue that a limited definition of good faith may not adequately capture all instances of bad faith behavior. Specifically, this understanding of good faith may not allow for the flexibility needed to ensure the program can fulfill its goals. Additionally, limiting the meaning of good faith to compliance with program rules would make any currently existing language in foreclosure mediation statutes referring to good faith superfluous. On the other hand, lenders may (as the mortgage company did in *Levya*) argue that substantial compliance should be sufficient. If lenders find it difficult to comply with rules, yet no consideration is given to that difficulty, courts may end up over-sanctioning lenders.[233] Again, these considerations suggest a middle ground that promises to consider all of the various interests.

2. *Good Faith in Action*

a. The New York Example

In 2009, the New York state legislature passed a law requiring the court "[i]n any residential foreclosure action involving a home loan" to hold a settlement conference no more than sixty days after the lender files proof of service.[234] This conference requirement applies to any borrower facing foreclosure of his or her primary residence located in New York.[235] Additionally, since the property must be "intended principally for occupancy of from one to four families," owners of apartment buildings cannot take advantage of the settlement conferences.[236]

Because New York is a judicial foreclosure state (in which a lender must go through the courts to foreclose on property securing a defaulted loan), settlement conferences are conducted as part of the court system. In practice, Judicial Hearing Officers or court-attorney referees preside over the negotiations.[237] In addition to these arbitrators, a judge can be made available to enter an order on the matter.[238] Due to the judicial nature of these proceedings, a defendant-homeowner appearing pro se may be entitled to representation by a court-appointed attorney.[239]

Under the New York law, the plaintiff and defendant are required to negotiate in good faith at a settlement conference.[240] The law does not

233. If courts regularly sanction lenders for behavior outside of their control, sanctions will lose some of their deterrent effect and lenders will likely begin to feel like the program is not fair.

234. N.Y. C.P.L.R. 3408(a) (McKinney 2012).

235. N.Y. REAL PROP. ACTS. LAW § 1304.5(b) (McKinney 2009); C.P.L.R. § 3408(a).

236. N.Y. REAL PROP. ACTS LAW § 1304.5(b).

237. JUDITH S. KAYE & ANN PFAU, N.Y. STATE UNIFIED COURT SYS., RESIDENTIAL MORTGAGE FORECLOSURES: PROMOTING EARLY COURT INTERVENTION 4 (2008), *available at* http://www.courts.state.ny.us/whatsnew/pdf/ResidentialForeclosure6-08.pdf.

238. *Id.*

239. C.P.L.R. § 3408(b).

240. *Id*. at § 3408(f).

specify what good faith participation means, however, instead leaving it up to the parties to determine what conduct will meet that standard.[241] Despite leaving "good faith" undefined, the statute does provide some guidance for what legislators meant for settlement conferences to achieve. According to the 2009 statute, the goal of the mandatory settlement conferences is to "help the defendant avoid losing his or her home" through a "mutually agreeable resolution."[242] To help reach this goal, the statute also requires that the plaintiff in each case must either attend the mediation or send counsel with full authority to settle the case.[243] This law appears to have been relatively successful in at least one respect—it has increased homeowner participation by expanding outreach efforts and requiring court notice be sent to defendants.[244] Additionally, although homeowner preparation is still somewhat low, many now consult an attorney before their conferences and arrive with all appropriate documentation.[245]

Despite the promising elements of the New York law, evidence suggests that it is not achieving its goals.[246] In 2009, the Center for New York City Neighborhoods conducted a survey of settlement conference participants to determine how well the program was working.[247] According to this survey, lenders' attorneys in New York City had a copy of an offer in the defendant's file only three percent of the time and knew of the status of an offer only six percent of the time.[248] Additionally, the plaintiff's attorney did not have the contact information for someone with settlement authority in eighty-seven percent of cases.[249] Without this basic preparation, plaintiffs' attorneys cannot realistically discuss options or be prepared to agree to settlement at the conference. According to a 2012 report, missing documents and settlement authority still "limit the productivity of the conference," although more defendants are now represented by counsel in the conferences.[250] These numbers suggest that in the vast majority of cases in New York City, settlement conferences are nothing more than a waste of time and money for everyone involved.

The lack of serious participation in these settlement conferences can potentially be remedied if courts take a more active role in enforcing the good faith requirement. In New York, some courts have imposed sanc-

241. *See* Winston, *supra* note 184, at 189.
242. C.P.L.R. § 3408(a).
243. *Id*.
244. CTR. FOR N.Y.C. NEIGHBORHOODS, *supra* note 193, at 10.
245. *Id*. at 11.
246. *See, e.g.*, *id*. at 5.
247. *See id*.
248. *Id*.
249. *Id*. at 6.
250. A. GAIL PRUDENTI, STATE OF N.Y. UNIFIED COURT SYSTEM, 2012 REPORT OF THE CHIEF ADMINISTRATOR OF THE COURTS PURSUANT TO CHAPTER 507 OF THE LAWS OF 2009, at 3 (2012), *available at* http://www.nylj.com/nylawyer/adgifs/decisions/112812report.pdf. To combat the problems relating to documentation and authority to settle, the Queens County Supreme Court began a pilot program in which court staff compile a complete set of documents to send to a bank representative before the conference takes place. *Id.* at 4.

tions on lenders for disregarding the good faith participation requirement. For example, the court in *Wells Fargo Bank v. Hughes* dismissed the plaintiff's foreclosure action after the bank offered the defendant a loan modification with an adjustable rate and refused to remove that provision even after the court directed it to do so.[251] The case was dismissed without prejudice, and the court ordered that no additional costs or attorney fees should be allowed without showing of good cause in the event that the plaintiff refiled the foreclosure action.[252] In so holding, the court emphasized the purpose of the law—to protect homeowners and prevent another foreclosure crisis from reoccurring in the future—and the negative view New York and much of the country hold of adjust-able rate mortgage (ARM) loans.[253]

Under this model of good faith, banks and lenders would be required to make offers that borrowers could realistically expect to fulfill, and not just in the short term. Without a fact-specific inquiry, however, this approach could require that banks take on significant additional risk without being able to implement the usual measures designed to counteract that risk. Under this regime, a subprime borrower could end up with loan terms designed for a borrower with much better credit and a much higher likelihood of repayment. This problem could be resolved by requiring that borrowers consult a housing counselor prior to their settlement conference, as a housing counselor would be able to look at financial and other information to determine the most realistic option for each homeowner.[254]

The New York Supreme Court for Suffolk County similarly took a hard-line stance against lenders in *Emigrant Mortage. Co. v. Corcione*.[255] After a delay in filing designed, in the court's view, to allow interest to accrue, and a "series of Foreclosure Settlement Conferences," the plaintiff finally proposed a loan modification agreement.[256] According to the court, the proposed agreement included numerous components indicating the bad faith of the plaintiff, such as claims for unexplained or unsubstantiated amounts of money, a clause in which the defendant waived any and all claims or defenses with regard to the mortgage debt, including those "intended to regulate the mortgage banking industry," and clauses in which the bank protected itself by retaining the right to foreclose but denying the borrower the right to utilize the protections of the bankruptcy law.[257] Based on the "over-reaching, shocking, willful and unconscionable" conduct of the plaintiff, the court denied Emigrant the right to col-

251. 897 N.Y.S.2d 605, 609–10 (N.Y. Sup. Ct. 2010).

252. *Id*. at 610.

253. *Id*. at 606–10.

254. *See Foreclosure Avoidance Counseling*, HUD.GOV, http://hud.gov/offices/hsg/sfh/hcc/fc/index.cfm (last visited Apr. 8, 2013) (outlining the services provided by HUD-approved foreclosure avoidance counselors).

255. 900 N.Y.S.2d 608 (N.Y. Sup. Ct. 2010), *vacated on reargument*, No. 2009-28917, 2010 WL 7014850 (N.Y. Sup. Ct. Oct. 14, 2010).

256. *Id*. at 609–10.

257. *Id*. at 611–13.

lect any of the claimed interest on the loan that accrued between the default date, May 1, 2008, and March 1, 2010.[258] The court additionally denied the plaintiff any recovery of legal fees and expenses or claimed advances.[259] Finally, the court determined that the conduct in this case was so egregious that the defendant could recover exemplary damages of $100,000 from the plaintiff.[260]

This extreme remedy may have proven successful. Six months after the court entered its judgment, the parties reconvened to request the court vacate the prior order.[261] This request was premised on successful negotiations between the parties resulting in an agreement on all issues.[262] According to the court, the plaintiff and defendant engaged in good faith negotiations after the entry of the judgment against the plaintiff, resulting in a settlement agreement with "fair, just and equitable" terms.[263] Thus, where parties can cooperate and reach a fair agreement, any sanctions contemplated (or already imposed) may be denied because such an outcome promotes the overarching goals of the settlement conference and good faith requirement.

Under this view of the good faith requirement, violations can be corrected such that sanctions are no longer appropriate. Because the purpose of the New York settlement conferences is to encourage agreement between the parties to allow more homeowners to remain in their homes,[264] this flexibility is important. If sanctions, once imposed, could not be vacated for subsequent good faith (including agreement of fair terms to a modification), lenders would have no incentive to reform their behavior, and homeowners might be denied a fair resolution of their foreclosure case. At the same time, the strictness of courts and the imposition of high sanctions serve as a deterrent to bad faith participation in the first place. This combination of high sanctions with the possibility of judicial vacatur promotes good behavior in the first instance and reformed behavior if sanctions are deemed appropriate at any point.

b. The Nevada Example

From 2007 through 2011, Nevada had the highest rate of foreclosure filings in the country.[265] In 2010, foreclosures were filed for nine percent

258. *Id.* at 614.
259. *Id*. at 614–15.
260. *Id*.
261. Emigrant Mortg. Co. v. Corcione, No. 2009-28917, 2010 WL 7014850, at *1 (N.Y. Sup. Ct. Oct. 14, 2010).
262. *Id*.
263. *Id*.
264. *See supra* note 234 and accompanying text.
265. Susanna Kim, *2010 Had Record 2.9 Million Foreclosures*, ABC NEWS (Jan. 13, 2011), http://abcnews.go.com/Business/2010-record-29-million-foreclosures/story?id=12602271; David McLaughlin & Joel Rosenblatt, *States with Highest Foreclosure Rates Among Bank Deal Holdouts*, BLOOMBERG BUSINESSWEEK (Feb. 7, 2012), http://www.businessweek.com/news/2012-02-07/states-with-highest-foreclosure-rates-among-bank-deal-holdouts.html. Nevada dropped to second in the nation in 2012, where it currently remains. Eli Segall, *Nevada Foreclosure Rate Remains Second Worst in Nation*,

of housing units in the state, meaning that one in eleven Nevada homes became the subject of a foreclosure proceeding.[266] In 2011, the numbers looked somewhat better with the Nevada foreclosure rate dropping to only six percent.[267] That rate still represented the highest foreclosure rate in the country, however.[268] By January 2013, although the rate of foreclosure filings had dropped significantly, the rate of notices of default (the beginning of the foreclosure process in Nevada) soared.[269] In January alone, there were 1827 notices of default—an increase of eighty-seven percent over January 2012.[270] To address this problem, the Nevada legislature enacted a law creating the State of Nevada Foreclosure Mediation Program (FMP) in 2009.[271] Although a homeowner must request mediation, once approved, participation is mandatory.[272] The request requirement is likely necessary in Nevada because lenders in Nevada can foreclose on homes by exercising power of sale clauses found in the deed of sale without going to court.[273]

According to the FMP website, the goal of the program "was to directly address the foreclosure crisis and to help keep families in their homes."[274] In theory, mediation is a win-win because parties can work together more quickly and efficiently to reach an agreeable solution.[275] To make this theory work in practice, the program requires that a representative of the lender with authority to modify the terms of the loans appear in person or by phone and that homeowners attend with an attorney licensed in Nevada, a licensed foreclosure or loan modification professional, or a HUD-approved housing counselor.[276] As with the New

VEGAS INC. (Feb.13, 2013, 9:01 PM), http://www.vegasinc.com/news/2013/feb/13/nevada-foreclosure-rate-remains-second-worst-natio/.

266. Kim, *supra* note 265.

267. McLaughlin & Rosenblatt, *supra* note 265.

268. *Id.*

269. Segall, *supra* note 265.

270. *Id.*

271. STATE OF NEV. FORECLOSURE MEDIATION PROGRAM, http://foreclosure.nevadajudiciary.us (last visited Apr. 8, 2013).

272. GEOFF WALSH, NAT'L CONSUMER LAW CTR., RECENT DEVELOPMENTS IN FORECLOSURE MEDIATION 16 app. A (2011), available at http://www.nclc.org/images/pdf/foreclosure_mortgage/mediation/npt-mediation-2011.pdf.; *see also* Prasad v. BAC Home Loan Servicing, LP, No. 2:10-cv-01857-RLH-PAL, 2011 WL 1304257, at *1, 3–4 (D. Nev. Apr. 1, 2011) (granting the defendant-lender's motion to dismiss plaintiff's petition for judicial review of lender's "Notice of Default and Election to Sell" because the homeowner did not timely elect mediation and thus the lender had a valid right to foreclose upon the property).

273. *See* LYNN M. LOPUCKI & ELIZABETH WARREN, SECURED CREDIT: A SYSTEMS APPROACH 35–36 (7th ed. 2011) (explaining real property foreclosure by power of sale); *Foreclosure Laws and Procedures by State*, REALTYTRAC, http://www.realtytrac.com/foreclosure-laws/foreclosure-laws-comparison.asp (last visited Apr. 8, 2013) (listing the various foreclosure laws of each state and describing the difference between judicial and nonjudicial foreclosures).

274. *About the Program*, STATE OF NEV. FORECLOSURE MEDIATION PROGRAM, http://foreclosure.nevadajudiciary.us/index.php/about-program (last visited Jan. 28, 2013).

275. *Id*.

276. STATE OF NEV. FORECLOSURE MEDIATION PROGRAM, FORECLOSURE MEDIATION FACTSHEET 1 (2011) [hereinafter FORECLOSURE MEDIATION FACTSHEET], *available at* http://www.nevadajudiciary.us/index.php/viewdocumentsandforms/func-startdown/5924/.

York program, all parties are required to participate in good faith.[277] Despite the separate requirements in the law, courts and mediators often conflate good faith with violations of the requirement to attend (with authority to settle) or to provide required documentation.[278]

Once a mediator finds a violation of any of the statutory requirements, he or she must recommend sanctions and deny certification of the foreclosure process.[279] According to Nevada courts, however, "[s]ubstantial compliance may be sufficient,"[280] meaning that compliance can be found where the purpose of the statute can be met.[281] This construction allows for flexibility where alleged violations would not or did not hinder the purposes of the FMP. According to the Nevada Judiciary, the program was relatively successful in its first year—with over 4200 homeowners participating, eighty-nine percent avoided foreclosure, and forty-six percent reached an agreement allowing the homeowner to remain in the home.[282] It is unclear from these statistics, however, how many eligible homeowners failed to participate in the program at all.

D. Sanctions

Without a threat of some punishment, a good faith requirement is not likely to affect the behavior of most participants. The loan servicers and their attorneys are essentially incentivized to pursue foreclosure even at high overall costs to investors (and homeowners).[283] On the other hand, sanctions that are too harsh may result in parties being coerced into accepting a deal that is unfair or overly accommodating. For instance, if a lender fears a particular sanction for failure to participate in good faith, the representative may offer a loan modification even when it is clear that the borrower would not be able to maintain payments on any modified plan. Such an outcome would not serve the purposes advanced by proponents of foreclosure modification, but instead would merely postpone the inevitable default and increase the costs associated with that case. In that situation, the lender risks losing even more of its investment if the value of the home is decreasing during the delay. This

277. *Id.*

278. *See, e.g.*, Pasillas v. HSBC Bank USA, 255 P.3d 1281, 1284 (Nev. 2011) (quoting the mediator in the case as finding a lack of good faith "as evidenced by its failure to produce required documents and information").

279. *Id.* at 1286. Without certification, a lender cannot proceed to sale of the property. *How Do We Obtain a Certificate to Foreclose?*, STATE OF NEV. FORECLOSURE MEDIATION PROGRAM, http://foreclosure.nevadajudiciary.us/index.php/faqs/35-trustees/84-how-do-we-obtain-a-certificate-to-foreclose (last visited Apr. 8, 2013). Denial of a certificate to foreclose does not, however, prohibit the lender from reinitiating nonjudicial foreclosure through a new notice of default. Holt v. Reg'l Tr. Servs. Corp., 266 P.3d 602, 603 (Nev. 2011). In such a situation, the homeowner can make another request for mediation since the lender effectively restarts the entire process by giving new notice of default. *See id.*

280. Leven v. Frey, 168 P.3d 712, 717 (Nev. 2007).

281. Leyva v. Nat'l Default Servicing Corp., 255 P.3d 1275, 1278 (Nev. 2011).

282. FORECLOSURE MEDIATION FACTSHEET, *supra* note 276, at 1–2.

283. *See supra* note 74 and accompanying text.

suggests that not only must sanctions be carefully applied in the right circumstances, but also that the type and severity of sanction must be appropriate.

1. Options for Lender Sanctions

When lenders do not comply with program requirements, courts have tools at their disposal to "encourage" compliance (for example, by ordering the servicer to comply with the rules at another session[284]). Without the possibility of sanctions, such an order would not ensure future participation and would be essentially worthless. This Subsection considers the most common sanctions imposed on lenders who do not demonstrate good faith in mediation and whether and how they can promote the goals of foreclosure mediation.

a. Dismiss Foreclosure Action or Prevent Servicer from Foreclosing

In some situations, conduct of the lender in a settlement conference or mediation session deviates so significantly from good faith participation that courts have found it appropriate to deny foreclosure altogether.[285] In Nevada, for example, courts cannot grant a foreclosure certificate (allowing foreclosure to proceed) to a lender who has not complied with the statutory requirements of mediation.[286] Typically, however, lenders retain the ability to refile the case[287] or recommence the foreclosure proceedings.[288] Essentially, then, this sanction is the equivalent of a delay for the servicer and the homeowner. This delay may be helpful for a homeowner who is searching for alternative living arrangements in case the lender is allowed to foreclose.[289]

Although typically considered a "severe sanction,"[290] dismissal may insufficiently deter bad behavior on the part of the lender and may in fact be problematic from the perspective of the homeowner. Specifically, if the dismissal is not paired with some type of financial sanction, the lender may be able to simply sit back and allow interest and fees to accrue—costs that will be passed on to the homeowner.[291] Additionally,

284. *See* NCLC, REBUILDING AMERICA, *supra* note 141, at 7.
285. *See id*. at 12–13.
286. *See, e.g*., Malloy v. Wells Fargo Bank, No. 56589, 2011 WL 5009421, at *1 (Nev. Oct. 18, 2011) (reversing the district court's order that a foreclosure certificate be issued and remanding to determine sanctions because the lender did not produce certain required documents at mediation). Because Nevada is a nonjudicial foreclosure state, there is no foreclosure proceeding for a court to dismiss. *See supra* note 266 and accompanying text.
287. *See, e.g*., Wells Fargo Bank, N.A. v. Hughes, 897 N.Y.S.2d 605, 609–10 (N.Y. Sup. Ct. 2010).
288. *See* Holt v. Reg'l Tr. Servs. Corp., 266 P.3d 602, 603 (Nev. 2011) (holding that "a lender who has been denied [a Foreclosure Mediation Program] certificate for failing to mediate in good faith can reinitiate foreclosure . . . thereby restarting the FMP process").
289. *See* WALSH, *supra* note 272, at 15.
290. *Id*.
291. *Id*.

many homeowners may grow frustrated with a foreclosure process that drags on with no apparent end in sight.[292]

b. Toll Accrual of Interest and Other Financial Penalties

Foreclosure mediation proponents and courts have noticed that delay in ability to foreclose on residential property can cause problems for the homeowners. The court in *Hughes*, for example, dismissed the case but also ordered that the lender be denied any additional costs or attorneys fees associated with any subsequent refiling of the case.[293] Lenders typically refuse to accept any payments from a homeowner in foreclosure, yet interest, fees, and costs continue to add up. This creates a greater financial burden that can decrease the possibility of securing a loan modification.[294] By transferring some of the cost of delay to the lenders, courts can potentially encourage mortgagees to deal fairly with homeowners at the initial court hearing.

Other courts have taken a slightly different approach, requiring lenders who negotiate in bad faith to pay damages to the homeowner. In *Emigrant Mortgage Co. v. Corcione*, discussed above,[295] the New York court ordered the lender to pay $100,000 to the homeowners as exemplary damages.[296] This sanction apparently convinced the mortgage company to reconsider its prior position, as the case was later vacated after the parties had come to an agreement.[297] This option specifically targets the incentive problem caused by separation between the lender and the financial stake in the outcome of negotiations.[298]

One potential problem with such financial penalties for failure to negotiate in good faith is that it may be difficult in some cases to determine whether it was bad faith behavior or ineligibility of the homeowner that caused the breakdown in negotiations.[299] Along the same lines, if lenders fear monetary sanctions even when their behavior may approximate good faith, they will likely adjust their behavior to account for that risk. Thus, for example, if a lender fears sanctions for failure to provide alternatives, it might come to the bargaining table with an unrealistic proposal intending to "negotiate down" to the offer it might have presented originally (but for the fear of sanctions). Additionally, overuse of sanctions could result in banks granting more modifications (or other settlements) to homeowners who have high risk of redefault, producing a

292. *Id*.
293. Wells Fargo Bank, N.A. v. Hughes, 897 N.Y.S.2d 605, 609–10 (N.Y. Sup. Ct. 2010).
294. WALSH, *supra* note 272, at 13.
295. *See supra* notes 255–60 and accompanying text.
296. Emigrant Mortg. Co. v. Corcione, 900 N.Y.S.2d 608, 615 (N.Y. Sup. Ct. 2010).
297. Emigrant Mortg. Co. v. Corcione, No. 2009-28917, 2010 WL 7014850 (N.Y. Sup. Ct. Oct. 14, 2010).
298. *See supra* note 164 and accompanying text (talking about why mortgage lenders do not have strong incentives to modify loans).
299. This is due, in part, to lender secrecy regarding NPV results. *See supra* notes 176–78 and accompanying text.

corresponding wave of new foreclosure filings in the future. It is important to take these concerns into account when developing a good faith component of a mediation program to ensure that the objectives of the program are not frustrated.

c. Order Loan Modification

The Nevada statute explicitly authorizes courts to sanction lenders by "requiring a loan modification in the manner determined proper by the court."[300] In one case, *Renslow v. Wells Fargo Bank*, the Nevada District Court ordered a loan modification modeled after HAMP modifications and incorporating the terms of a trial modification that the bank had previously offered the homeowners.[301] The court determined that it had authority to order that particular sanction based on its equitable powers, regardless of what the statute said.[302] Appeal is pending, and oral arguments were heard on October 19, 2012, so the question will soon be resolved one way or the other.[303]

Although it is still uncertain whether this option is available outside of Nevada, it could provide a direct means of achieving the goals of foreclosure mediation. Because the goal of the program is to prevent unnecessary foreclosures, requiring a bank to modify certain loans as a sanction for bad behavior seems to be a logical step. Not all instances of lender misconduct would warrant applying this sanction, however. In the *Renslow* case, the remedy was appropriate in part because of the type of misconduct.[304] Specifically, the bank suggested to the homeowners that they could receive a modification but told them to stop making payments in order to qualify, thereby putting the homeowners in a worse situation than they otherwise would have faced.[305] Additionally, it is important to remember that no beneficial purpose is served by requiring unsustainable loan modifications that will likely result in redefault. Even keeping these considerations in mind, however, sanctioning lenders by requiring loan modifications has the potential to encourage lender participation,[306] increase the number of successfully modified loans,[307] and reduce the burden on courts.[308]

300. NEV. REV. STAT. § 107.086(5) (2009) (amended 2011).
301. NCLC, REBUILDING AMERICA, *supra* note 141, at 29.
302. *Id*.
303. *Id*.; *see also Oral Arguments*: Wells Fargo Bank v. Renslow, NEV. JUDICIARY—SUPREME COURT, http://www.nevadajudiciary.us/index.php/oralarguments/1664-wells-fargo-bank-vs-renslow- (last visited Apr. 8, 2013).
304. NCLC, REBUILDING AMERICA, *supra* note 141, a 29.
305. *Id*.
306. The possibility of coerced loan modification may encourage lenders to participate meaningfully in mediation sessions where the lender would prefer a different alternative (for example, a short sale).
307. Because banks often do not have strong incentives to modify loans, a court mandate would create the necessary push toward loan modification.
308. The sanction of requiring a loan modification essentially limits the court's role to minor oversight duties.

2. *Options for Homeowner Sanctions*

Little has been written or discussed about providing sanctions to homeowners who fail to participate in good faith in foreclosure mediation. This might be a result of biases of foreclosure mediation's supporters[309] or an assumption that homeowners already have sufficient motivation to participate in good faith because they want to save their homes or credit scores. Although homeowners do tend to have stronger participation incentives than lenders, homeowner participation and behavior is not perfect.[310] Ordering sanctions for those homeowners who fail to participate in good faith can provide a remedy for this problem and ensure that all the parties view the procedures as essentially fair.[311] Additionally, sanctions for homeowners, particularly homeowners who fail to attend mediation or do not bring the proper documentation, can potentially reduce the strain on courts by limiting the program to those homeowners who are serious about working out a solution with the bank.

In Cook County (encompassing Chicago), judges are authorized to order sanctions "[i]f either the homeowner or lender fails to attend mediation without good cause."[312] It is unclear what might constitute "good cause" (or lack thereof), but this rule has the potential to minimize time wasted at mediation sessions without full participation.

3. *What the Enforcement Requires*

In order to impose sanctions on a party for failure to participate in good faith, the court must have some way of knowing what exactly went on during the mediation session. Mediation programs often rely on neutral mediators to perform this function. For example, mediators in the Nevada program provide lenders with a certificate to foreclose if the mediation is unsuccessful and the lender followed all of the statutory rules.[313] The Nevada mediator additionally provides the court with a statement after mediation outlining the results of the mediation, noting whether the parties complied with all statutory requirements and recommending sanctions where appropriate.[314] The Nevada system also sets up proce-

309. One of the major organizations writing about how to improve (and best utilize) foreclosure mediation programs is the National Consumer Law Center (NCLC). According to its website, NCLC "is a nonprofit advocacy organization that seeks to build economic security and family wealth for low-income and other economically disadvantaged Americans." *Development Officer*, NAT'L CONSUMER LAW CTR., http://www.nclc.org/about-us/about-us/development-officer.html (last visited Apr. 8, 2013).

310. *See, e.g.*, *supra* notes 229–30 and accompanying text.

311. *Cf.* Kovach, *supra* note 162, at 584 ("Mediation should provide a fair process to all of the participants while leaving the result and its fairness issue to them.").

312. *Programs: Mortgage Foreclosure Mediation Program—Cook County Circuit Court*, RESOLUTION SYSTEMS INSTITUTE'S COURT ADR RESOURCE CENTER, http://courtadr.org/sourcebook/programs.php?ID=90 (last visited Apr. 8, 2013).

313. NEV. REV. STAT. § 107.086(7) (2009) (amended 2011).

314. *See* NEV. SUP. CT. R. 17, *available at* http://www.nevadajudiciary.us/images/foreclosure/adkt435amendedrules.pdf.

dures for challenging the results of mediation.[315] Thus, if homeowners feel their lender did not comply with the requirements or otherwise participate in good faith, they can petition the court to review the decision.[316] During this review, the court looks at the mediator's statement and can require the mediator to testify about that statement and the content of the proceedings.[317]

The roles of impartial arbitrator and court informant may be (or at least may appear to be) in conflict.[318] When a court requires a mediator or participant to testify as to the supposedly confidential mediation proceedings, critical mediator neutrality can be lost.[319] Without receiving some credible information from someone present at the mediation, however, the court cannot enforce good faith participation in a consistent, principled manner.[320] Although it may not be feasible to remove this problem entirely, having objective standards for what constitutes good faith will provide mediators and all participants with clear expectations about what information will be kept confidential and what will potentially be reported to the court. By managing expectations and limiting the content of information about which mediators can be required to testify, the neutrality of the mediator can be protected.

IV. RECOMMENDATIONS FOR A BALANCED APPROACH

The goal of this Part is to balance the competing interests at stake and develop a coherent model of a good faith requirement along with appropriate sanctions. Briefly, the model requires parties to act in compliance with program rules and in furtherance of program goals. Failure to do so results in sanctions tailored to the particular circumstances of the case. This model should advance the general goals of foreclosure mediation programs, including reduction in overall foreclosure numbers, while (or more likely by) ensuring that the parties view the system as essentially fair and predictable.[321] This will require clear rules and consistent enforcement. Section A of this Part provides a template for an ideal understanding of the good faith requirement in mortgage foreclosure mediation programs. Section B then considers the enforcement side, specifically addressing what sanctions are appropriate and when.

---

315. FORECLOSURE MEDIATION FACTSHEET, *supra* note 276, at 2.

316. *Id*. Lenders also have the option to petition the court for judicial review. *Id*.

317. NEV. REV. STAT. § 107.086 (2009) (amended 2011); NEV. ST. FORECLOSURE MEDIATION RULES 21.

318. *See, e.g.*, Lande, *supra* note 185, at 8 (discussing the problems with requiring mediators or participants to testify as to the usually confidential mediation proceedings).

319. *See* Lande, *supra* note 185, at 3 ("[E]nforcing [good faith] requirements would result in a major intrusion into the mediation process and violation of confidentiality protections."); Schneider & Fleury, *supra* note 198, at 385 ("Mediator neutrality or impartiality is crucial to the success of a mediation program.

320. *See* NCLC, CAN THEY SAVE HOMES?, *supra* note 28, at 20–21 (recommending that mediators be required to provide certification that the parties "complied in good faith with their duties under the mediation rules" before the lender can proceed with foreclosure).

321. *See supra* notes 188, 198 and accompanying text.

A. Good Faith Requirement

Despite some of the problems with good faith requirements in general,[322] a clear good faith standard has the potential to alter the incentive and power structures of current foreclosure mediations. Typically good faith is defined using a negative definition—that is, by defining what qualifies as bad faith (or not good faith).[323] In the foreclosure setting, however, it is possible to identify specific behaviors that qualify as good faith, making the application of such a standard more predictable and fair. This Section lays out general components of a model good faith requirement as well as specific behaviors encompassed by the definition.

In order for a good faith requirement to be useful, it should cover more types of behaviors than are required by the program rules alone and should further the goals of the program. Thus, although complying with all of the rules of the mediation program may be some evidence of good faith participation, it should not and cannot be sufficient. Foreclosure mediation programs have been implemented for very specific reasons and are designed to confront very specific problems,[324] and participant behavior should reflect that. Therefore, a good faith requirement must include compliance with program rules as well as any additional behaviors necessary to promote the goals of the program.

Merely requiring that parties engage in behaviors necessary to promote the goals of the program, however, would not promote the predictability that is required for the success of a good faith requirement.[325] The specific behaviors that are required will vary for lenders and homeowners, at least in part because the parties face different obstacles to meaningful participation. There will be some requirements that apply to both parties, however. For example, both parties must attend any scheduled mediation session and must arrive on time. The time of the mediators, attorneys, any attending parties, and the court itself is valuable, and it is not fair to anyone involved for one party to cause undue delay. Along the same lines, the parties should attend mediation prepared to negotiate and reach a settlement. This requirement furthers the goal of avoiding unnecessary foreclosures because if parties are ready to have meaningful negotiation, more cases will settle without resulting in foreclosure.

The requirement that parties attend mediation "prepared to negotiate" includes several additional requirements. First, both parties should know the options available for the specific case. For the lender, this means knowing whether the homeowners qualify for a loan modification and, if so, what is the best deal the lender is able to give. If the homeowner does not qualify, the lender should be prepared to explain why

322. *See supra* Part III.B.2.

323. *See* Maureen A. Weston, *Checks on Participant Conduct in Compulsory ADR: Reconciling the Tension in the Need for Good-Faith Participation, Autonomy, and Confidentiality*, 76 IND. L.J. 591, 622 (2001).

324. *See supra* notes 159–64 and accompanying text.

325. *See supra* Part III.C.1.d.

and should know what other possible settlements might be available.[326] For example, the new rules promulgated by the Illinois Supreme Court address the problem by requiring lenders to file an affidavit stating that they have attempted all applicable foreclosure avoidance methods before they can file for a judgment of foreclosure.[327]

For the homeowner, this knowledge requirement will likely involve meeting with a housing counselor to discuss what options are financially realistic. Given that information, the homeowners should come into mediation knowing whether they would be willing to settle for an option that involves moving out of the home.[328] For both parties, therefore, participating in good faith must mean considering all feasible options.[329]

The second component to the preparedness requirement is that the parties must bring to mediation all documentation either required by the program or otherwise necessary to reach a resolution. To comply with this requirement, homeowners must bring any financial information or updates that the lender needs in order to make a decision about whether to approve a loan modification or other settlement option. Homeowners should also bring any documentation related to a HAMP application or a modification offered by the bank. Finally, if a homeowner has met with a housing counselor, any documentation related to that meeting should also be provided. This information may be useful to the lender or mediator in determining what options are realistically available to the parties.[330]

The lender must also comply with documentation requirements. One particularly important piece of documentation that should be requested is the Net Present Value calculation.[331] Due to the greater availability of the NPV calculations, the lender can no longer claim the information as proprietary.[332] Additionally, requiring disclosure of the NPV calculation may transfer some of the power from servicers to homeowners by limiting the discretion lenders have in denying modifications. By comparing financial information provided by both parties, the mediator should be able to determine whether the calculation actually shows that the homeowner does not qualify for a modification. Additionally, if the lender refuses to authorize a modification, the mediator should be able to tell whether this denial comports with the financial facts provided by the parties. Aside from NPV calculations, lenders should also be required to provide any additional information necessary to settle the

326. *See supra* Part II.B.

327. ILL. SUP. CT. R. 114(a); *see also* notes 149–52 and accompanying text.

328. *See supra* Part II.B.2.

329. Under this requirement, a lender must consider a loan modification where it is realistic given the specific financial circumstances of the homeowner, and a homeowner must be willing to listen to a lender's offer for a graceful exit where a modification is not financially practicable.

330. To be even more effective, this documentation should be provided *before* the mediation so the bank has a chance to look it over. This will help ensure that the mediation is maximally productive.

331. *See* Glink, *supra* note 176; *supra* notes 176–78 and accompanying text.

332. *See supra* notes 223–24 and accompanying text.

case.[333] By providing all of this information, the parties can help make sure the mediation will run smoothly and have the greatest possible likelihood of success.

Finally, there are certain behaviors that need be required only of lenders. First, it is essential that the lender's representative at mediation have real authority to settle the case. Because of the practical difficulties of this requirement,[334] most programs allow the representative to appear by telephone.[335] Even where the complicated nature of securitized mortgages makes actual participation difficult, good faith compliance could require that the parties work out some alternate arrangement. For example, lenders could coordinate with investors prior to the date of mediation so as to effectively give the lender's representative sufficient settlement authority on behalf of all interested parties. Alternatively, lenders could negotiate with homeowners at the mediation and reach a tentative agreement subject to approval by the investor. Because the investor typically faces greater losses from foreclosure (versus modification or some other solution) than does the lender, it is less likely that the investor would unreasonably withhold approval, and more foreclosures can be avoided.

The final requirement of lenders in mediation is that they must present realistic settlement options to the homeowners. Determining what is realistic will require a case-by-case assessment, and, unfortunately, for some homeowners this may be limited to some less than desirable options.[336] This assessment should take into account the homeowner's financial situation and whether they qualify for HAMP, as well as the terms of any offers made by the lender.[337] If lenders refuse to offer a loan modification to a homeowner, however, these homeowners should have the right of at least knowing why they are being denied. Requiring a reason, particularly in conjunction with the documentation requirements, may reduce the number of homeowners denied a loan modification, as the mediator and/or homeowner could check the lender's financial reasons against the documentation brought to the mediation.

Although this discussion outlines the major components of a good faith requirement, there may be some unanticipated behavior by either party that a court may find to be frustrating the purposes of the mediation program. In such instances the burden to show bad faith should be somewhat higher, but a finding of bad faith should not be absolutely barred. This final caveat to the good faith requirement preserves flexibility while also ensuring a high level of predictability.

333. This may include documentation of "pooling and servicing agreements, appraisals, and . . . histories that would facilitate options other than foreclosure." Glink, *supra* note 176.

334. *See supra* notes 190–93 and accompanying text.

335. NCLC, CAN THEY SAVE HOMES?, *supra* note 28, at 3.

336. For some homeowners, keeping their home may not be an option. *See supra* Part II.B.2.

337. For a good example of this analysis, see Emigrant Mortg. Co. v. Corcione, 900 N.Y.S.2d 608, 613–15 (N.Y. Sup. Ct. 2010).

B. Sanctions

Even with a clearer definition of good faith, compliance cannot be assured unless there is some threat of punishment for violations. The threat must be strong enough to deter bad behavior, yet not so strong as to pressure lenders to agree to inefficient settlements.[338] The purpose of foreclosure mediation is to avoid *unnecessary* foreclosures, and the unfortunate reality is that some (perhaps even many) foreclosures cannot be avoided at this time. Before ordering sanctions, it may be beneficial for judges to order compliance with program rules within a reasonable amount of time.[339] If parties can be "encouraged" to participate in mediation in a meaningful manner without having to require mediation, it is less likely that sanctions will effectively coerce inefficient or unsustainable loan modifications. In the event that either party fails to comply with a court order (or where a court order would not be helpful), appropriate sanctions could be ordered. When ordering sanctions, judges can help promote the goals of foreclosure mediation programs by considering the financial situation of the homeowners in conjunction with the behavior of the party supposedly acting in bad faith.

The purpose of considering the financial status of the homeowner is to determine the feasibility of avoiding foreclosure in each particular case. Because the goal of foreclosure mediation is primarily to reduce unnecessary foreclosures, sanctions designed to encourage lenders to reach a settlement may not be warranted where the homeowner's situation does not allow for foreclosure avoidance. Additionally, courts may be able to tailor sanctions to the specific financial situation of the homeowners. Thus, if a homeowner qualifies for a loan modification (e.g., under HAMP guidelines[340]), a court may sanction a lender found to have negotiated in bad faith by requiring the lender to offer a loan modification. This loan modification could be based on HAMP guidelines or a trial modification already granted to the homeowner (but not made permanent), or some other guidelines.

In addition to considering the financial circumstances of the homeowner, courts should also look to the behavior of the party who allegedly negotiated in bad faith. In cases of homeowners who fail to negotiate in good faith, courts should first keep in mind that foreclosure is often (if not always) a sanction in itself. By failing to participate in good faith (without good reason), homeowners may be considered to have lost the right to continue in the program. In such cases, the maximum sanction available should be denial of the right to continue in the program. In order to prevent unnecessary foreclosures, however, courts should seek lighter sanctions where appropriate (i.e., where a non-foreclosure solu-

338. *See supra* notes 169–71 and accompanying text.
339. *See, e.g.*, Wells Fargo Bank, N.A. v. Hughes, 897 N.Y.S.2d 605 (N.Y. Sup. Ct. 2010).
340. *See supra* notes 119–23 and accompanying text.

tion may be possible) given the homeowner's financial situation and the conduct of the parties.

In the reverse context, in which the lender has failed to participate in good faith, the specifics of the lender's behavior can be useful in applying sanctions. Lender bad faith typically falls into one (or more) of three categories. First, behavior may be designed to delay the proceedings and thereby allow costs, fees, and interest to accrue. Second, lenders may make unreasonable proposals and otherwise participate with general unwillingness to negotiate. Third, behavior may include inducements and other general bad behavior that causes detrimental reliance by the homeowner. Each of these categories of behavior may hinder the ability of the program to meet its goals in different ways. Thus, different sanctions may be appropriate to remedy the situation in each case.

Lender behavior that causes delay can come in various forms. For example, a lender appearing at mediation without requisite authority or without the necessary documentation would delay the process by requiring approval to be given later. Alternatively, lenders might cause delay by discussing modification with a homeowner but continually requesting more information or documentation from the homeowner.[341] During all this time, fees, costs, and interest continue to accrue, all of which will be added to the homeowner's burden.[342] Because these costs are transferred to the homeowner, the lender has no incentive to speed up the process, and sanctions should be tailored accordingly. Thus, if lender noncompliance is causing delay, a court may issue an order compelling performance and/or toll those added costs to transfer the price of delay to the lender. If lender noncompliance continues or is extreme, a court may even consider ordering the lender to pay a fine to further adjust the incentive structure.

The second category of bad faith actions may overlap somewhat with the first, as unwillingness to negotiate may result in some delay as well. This second category is best exemplified by the conduct at issue in *Wells Fargo Bank, N.A. v. Hughes*.[343] In that case, the lender proposed a loan modification with terms, including an adjustable rate mortgage,[344] that were "unacceptable" to the New York court, and the lender refused to alter it despite a court "directive."[345] The court primarily objected to the nature of the agreement in that it "fl[ew] in the face of the . . . legislation . . . designed to assist borrowers in foreclosure cases to remain in their homes and to prevent a foreclosure crisis like the one currently

341. *See, e.g.*, Stephanie Armour, *Home Mortgage Modification Snags Spark Lawsuits*, USA TODAY (Sept. 13, 2010, 1:45 PM), http://www.usatoday.com/money/economy/housing/2010-09-10-mortgagemods10_CV_N.htm ("[B]orrowers . . . allege that over periods of months, they repeatedly sent banks requested documents that the banks said they didn't receive, made inquiries that went unanswered, and received promises of help that were later contradicted or denied by other representatives.").

342. *See supra* notes 291, 294 and accompanying text.

343. *Hughes*, 897 N.Y.S.2d at 605; *see also supra* notes 247–49 and accompanying text.

344. *See supra* note 21 and accompanying text.

345. *Hughes*, 897 N.Y.S.2d at 609.

gripping . . . the nation from re-occurring in the future."[346] As the court noted, a modification agreement may contain unrealistic terms that substantially increase the possibility of redefault.[347] If these terms can be excluded (without causing losses to investors greater than those losses from a foreclosure of the property), sanctions should be ordered to allow for that possibility. In some cases, tolling of fees may be sufficient to reduce monthly payments to realistic levels. In other cases, fines may be ordered to "encourage" further negotiation.[348] Finally, a court may be justified in ordering the lender to modify the loan according to certain terms.[349]

The final category of lender misconduct in negotiations is somewhat more blurred, as it includes behaviors (including inducements) that the homeowners rely on to their detriment. Thus, for example, a lender may convince a homeowner on the verge of default that loan modification may be an option only if they cease making monthly payments.[350] If the lender is allowed to induce homeowners to fall into foreclosure without receiving the promised modification, there will be additional unnecessary foreclosures actually induced by the lenders. In this type of situation, sanctions should be designed to prevent any harm to the homeowner that is caused by reliance on lender conduct or statements. Thus, in the case of a lender inducing a homeowner to default using the promise of loan modification, a court may order a loan modification along the lines of any promised modification. Thus, sanctions in these detrimental reliance situations should be designed to negate the effects of the reliance.

Because the circumstances of each case will vary, and the categories of bad faith behavior may overlap, sanctions should be determined on a case-by-case basis, keeping in mind the financial situation of the homeowner, the particular bad faith involved, and the goals of foreclosure mediation generally. By doing this, sanctions will be more predictable and will better shape the behavior of the parties without compromising the goals of the program.

V. CONCLUSION

Even as the financial situation in this country improves, the foreclosure rate has remained high, casting millions of Americans out of their homes and resulting in massive financial losses to investors.[351] Some state

346. *Id*.

347. *See id.*

348. Emigrant Mortg. Co. v. Corcione, 900 N.Y.S.2d 608 (N.Y. Sup. Ct. 2010), *vacated* on reargument, No. 2009-28917, 2010 WL 7014850 (N.Y. Sup. Ct. 2010).

349. For example, a court could use HAMP guidelines or implement terms of a successful trial modification that was never made permanent.

350. NCLC, REBUILDING AMERICA, *supra* note 141, at 29 (describing the recent case, Renslow v. Wells Fargo Bank, No. CV10-03382 (Nev. Dist. Ct. filed Nov. 9, 2010), in which the lender told the homeowners to stop making payments so they could qualify for HAMP but subsequently refused to make the trial modification plan permanent).

351. *See* EVANS & JACOBIUS, *supra* note 172, at 5 (providing statistics for the Cook County area).

and local governments have begun implementing mortgage foreclosure programs to increase communication between borrowers and lenders and to hopefully reduce the number of unnecessary foreclosures. Despite some successes, most programs "routinely fail to impose significant obligations on mortgage servicers," obligations without which "it is unlikely that mediations will lead to fewer foreclosures."[352] This Note has shown that greater accountability and better results can be achieved by implementing a clear, predictable understanding of good faith participation with appropriately tailored sanctions for noncompliance. By defining what participation is required and ordering sanctions that shift the power and incentive structure of the parties, a good faith obligation can significantly improve the potential for a foreclosure mediation program to prevent unnecessary foreclosures.

352. *U.S. Home Foreclosure Mediation in Jeopardy—Report, supra* note 154.