

# ABHORRING A FORFEITURE: THE IMPORTANCE OF EQUITABLE JURISDICTION IN A FORECLOSURE CRISIS\*

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## I. INTRODUCTION

A full treatment of foreclosure law requires detailed attention to both the lender's easily quantified monetary concerns and the borrower's harder-to-quantify concerns. While the homeowner is attempting to save a home—and everything it stands for—the lender is trying to enforce a security interest as efficiently as possible.<sup>1</sup> While the homeowner urgently wants to resolve one specific case, the lender is concerned about the expected return of all the foreclosures in its portfolio.<sup>2</sup> The marks on a homeowner's living room door that chart his or her children's height may be an irreplaceable treasure to the owner,<sup>3</sup> but to the lender, these same

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1. See James W. Bowers, *Security Interests, Creditors' Priorities and Bankruptcy*, in *Encyclopedia of Law and Economics* vol. 1, § 1500, at 95 (Boudewijn Bouckaert & Gerrit De Geest eds., Edward Elgar Cheltenham & U. of Ghent 2000) (available at <http://encyclo.findlaw.com/1500book.pdf>) (discussing how security interests can affect the priority of creditors).

2. See Shana H. Khader, Student Author, *Mediating Mediations: Protecting the Homeowner's Right to Self-Determination in Foreclosure Mediation Programs*, 44 *Colum. J.L. & Soc. Probs.* 109, 129–130 (2010) (explaining that lenders are “repeat players” who try a large number of cases while homeowners are likely “one-shotters” who are at a disadvantage because they only have a single opportunity).

3. See David A. Super, *Defending Mortgage Foreclosures: Seeking a Role for Equity*, 43 *Clearinghouse Rev.* 104, 108 (2009) (noting the “emotional equity” lost by mortgagors).

marks are small blemishes that will need to be painted over before the property can be liquidated.<sup>4</sup>

This contrast is raised not to accuse the lender of lacking empathy, but to highlight the difficulties in weighing interests that are fundamentally different in nature. Foreclosure law is situated at the intersection of commercial and consumer law.

Commercial law protects business, and thus it asks the court to pay attention to predictability and efficiency.<sup>5</sup> Consumer law, on the other hand, protects the unsophisticated consumer and raises concerns about fairness to the public.<sup>6</sup> A foreclosure suit involves both policies. On one side, the consumer is trying to protect his or her home and everything it means, both physically and psychologically. On the other side, a mortgagor is attempting to enforce a security interest.<sup>7</sup>

While there is a very real, human element to the way a foreclosure suit affects a homeowner, the lender's interests are limited to its financial stake—and the human element is taken out of play as much as possible. Mortgage servicers bring suit in accordance with binding Pooling and Servicing Agreements.<sup>8</sup> In many cases, the decision to foreclose is made by algorithm.<sup>9</sup> A

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4. See Kristin M. Pinkston, *In the Weeds: Homeowners Falling Behind on Their Mortgages, Lenders Playing the Foreclosure Game, and Cities Left Paying the Price*, 34 S. Ill. U. L.J. 621, 633–634 (2010) (discussing various ways that lenders try to avoid such maintenance costs).

5. See e.g. *Menichini v. Grant*, 995 F.2d 1224, 1230 (3d Cir. 1993) (discussing the “UCC objectives of predictability and finality in commercial transactions” and a court’s resulting emphasis on efficiency).

6. See e.g. *Gammon v. GC Servs. L.P.*, 27 F.3d 1254, 1257 (7th Cir. 1994) (discussing the “unsophisticated consumer standard”—a standard often used in consumer protection laws—and how it “protects the consumer who is uninformed, naive, or trusting, yet it admits an objective element of reasonableness”).

7. *Black’s Law Dictionary* defines a *security interest* as “[a] property interest created by agreement or by operation of law to secure performance of an obligation ([especially] repayment of a debt).” *Black’s Law Dictionary* 1478 (Bryan A. Garner ed., 9th ed., West 2009).

8. Pooling and Servicing Agreements are contracts under which “servicers carry out their duties” and responsibilities. Adam J. Levitin & Tara Twomey, *Mortgage Servicing*, 28 Yale J. on Reg. 1, 31 (2011). For more detail on Pooling and Servicing Agreements, see generally Anita Lynn Lapidus, *What Really Happened: Ibanez and the Case for Using the Actual Transfer Documents*, 41 Stetson L. Rev. 817 (2012).

9. See Alexandra Andrews & Emily Witt, *The Secret Test That Ensures Lenders Win on Loan Mods*, <http://www.propublica.org/article/the-secret-test-that-ensures-lenders-win-on-loan-mods-915> (posted Sept. 15, 2009, 3:18 p.m.) (describing the “Net Present Value test” that drives some decisions about whether to grant a loan modification).

computer even hires the foreclosure firm itself.<sup>10</sup> In sum, while a nominal party seeking foreclosure has almost no personal involvement in, or even knowledge of, the action, homeowners facing foreclosure face the possibility of losing their home.

As the lender's interest is predominantly financial, it may be easier to quantify than the more human concerns of the homeowner. Even those who might view the anticipated emotional pain caused by the loss of a home as insufficiently concrete for serious consideration must acknowledge costs caused by stress-related hospitalization<sup>11</sup> or costs to a community caused by increased crime rates attributable to foreclosure.<sup>12</sup>

While previous literature has discussed financial waste,<sup>13</sup> this Article seeks to expand the concept of waste to include harder-to-quantify damages. In today's crisis, rushing to foreclosure not only ignores the values at stake for the homeowner but is financially harmful to the lender.<sup>14</sup> Instead, this Article argues that the way to address both the homeowner and lender's best interests is to search out alternative methods for handling the crisis.

As discussed below, courts have mitigated the harsh consequences of the strict enforcement of contract law through centuries of judge-created principles of equity.<sup>15</sup> The unique nature of today's foreclosure crisis makes the judiciary's use of these equitable powers even more important. Part II of this Article paints a broad picture of the foreclosure crisis, including who the various parties are, what values are at stake, and when a foreclosure merits particular scrutiny to avoid unnecessary harm to homeowners, families, or communities. Part III explains how

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10. See Scot J. Paltrow, *Foreclosure Giant Lender Processing Services Faces Growing Legal Trouble*, [http://www.huffingtonpost.com/2010/12/06/lender-processing-services-legal-woes\\_n\\_792659.html](http://www.huffingtonpost.com/2010/12/06/lender-processing-services-legal-woes_n_792659.html) (posted Dec. 6, 2010, 2:00 p.m. ET) (describing how Lender Processing Services—which handles over half of the nation's foreclosure cases—uses a computer to automatically assign ratings to firms it hires based on how quickly the firms filed foreclosure actions).

11. See Janet Currie & Erdal Tekin, *Is the Foreclosure Crisis Making Us Sick?* 3–4 (Nat'l Bureau Econ. Research, Working Paper No. 17310, Aug. 2011) (finding an increase in hospitalizations for anxiety, suicide attempts, and hypertension in zip codes with high rates of foreclosure).

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

13. Super, *supra* n. 3, at 108.

14. See *infra* pt. II(D)(2) (discussing how lenders sometimes act against their own interests).

15. See *infra* pt. III (discussing the history of equity).

equity developed over centuries to mitigate the effects of strict contract enforcement and how foreclosure law developed through those courts of equity, which gives modern judges the power to create equitable solutions to our current crisis. Finally, Part IV suggests ways in which courts or legislatures may use non-traditional, equitable means to mitigate the consequences of strict contract enforcement in modern foreclosure suits to address today's foreclosure crisis and to further both the noteholders' interests in predictability and efficiency and the homeowners' interests in fairness and flexibility.

## II. VALUES AT STAKE IN A FORECLOSURE SUIT

### A. What We Talk about When We Talk about Foreclosure

The values at stake in our current foreclosure crisis warrant using equitable discretion to decide foreclosure suits. Balancing equitable concerns<sup>16</sup> in a foreclosure suit requires detailed consideration of all relevant facts to a case. While speaking generally about equitable concerns in foreclosure is difficult because there is no "typical" foreclosure suit,<sup>17</sup> there are several common fact patterns that can provide a sense of the values at stake in the current Great Recession.<sup>18</sup>

Before outlining these values, it is important to note that there are patterns where judicial equitable powers may not be the best method of resolving a case. This Article is meant to address the most common situation in today's foreclosure crisis: homeowners who wish to stay in their home but, due to reduced income or increased expenses, have missed one or more mortgage payments.

There are circumstances in which homeowners no longer wish to own their property, and they will abandon the house for

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16. *Infra* pt. III (discussing historical equity).

17. Sam Brock, *Behind the Scenes Look at Foreclosure Process*, <http://www.tv3winchester.com/home/headlines/20582999.html> (posted June 19, 2008, 7:53 p.m.) (paraphrasing Dallas Croft, a veteran realtor, who says "there is no 'typical' foreclosure").

18. See Courtney Schlisserman, *'Great Recession' Gets Recognition as Entry in AP Stylebook*, <http://www.bloomberg.com/apps/news?pid=newsarchive&sid=ayojB2KWQG4k> (Feb. 23, 2010) (stating that the *AP Stylebook Online* added the term "Great Recession" to refer to the "downturn that began in December 2007").

one of many reasons.<sup>19</sup> If a property is vacant and abandoned, a fast and efficient foreclosure may be an effective mechanism to return the property to valuable use.<sup>20</sup> Thus, this Article is not intended to address foreclosure under these circumstances. Of course, it would be important for courts to ensure that the property is actually abandoned, that any foreclosure suit is brought by the correct party, and that the foreclosing party avoids creating a nuisance property. Similarly, some foreclosures occur on investment properties, where the owner's interest in the property is primarily financial.<sup>21</sup> This Article is likewise not directed at these types of foreclosures.

Finally, the equitable concerns addressed in this Article are not intended to supplant existing legal defenses or the too-common situation when a bank error causes foreclosure.<sup>22</sup> Homeowners with legal defenses can resolve their suits by litigating defenses to the full extent of the law. In a personal example, one of the Authors' clients made every mortgage payment, but the records of several payments made were lost in a servicing transfer.<sup>23</sup> The lender's failure to recognize those payments resulted in a cascade of additional fees and prolonged loss-mitigation procedures that made the homeowners appear to be more and more

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19. See e.g. Cary Spivak, 'Walkaway' Properties Quickly Deteriorate, Dragging Down Borrowers and Neighborhoods, <http://www.jsonline.com/watchdog/watchdogreports/50548282.html> (posted July 11, 2009) (noting that "[f]or years, lenders complained about debtors who left the keys on the kitchen table and skipped town, leaving it to the bank to file for foreclosure and eventually take title by buying it at a sheriff's sale").

20. But see *id.* (discussing the new trend of various lenders walking away and never recovering title to foreclosed homes from the defaulting homeowners).

21. See James H. Carr & Kate Davidoff, *Legislative and Regulatory Responses to the Foreclosure Crisis*, 17 J. Afford. Hous. & Community Dev. L. 283, 283 (2008) (discussing the increase in foreclosures of investment properties resulting from a decrease in housing prices).

22. See e.g. Paul Kiel, *Bank Errors Continue to Cause Wrongful Foreclosures*, <http://www.propublica.org/article/bank-errors-continue-to-cause-wrongful-foreclosures/single> (posted June 24, 2011, 12:45 p.m.) (stating that ninety-four percent of foreclosure-avoidance counselors surveyed "reported having worked with clients who'd lost their homes while under review for a modification," despite the banks' promises not to foreclose on such homeowners); Marian Wang, *Primer: What Is a Wrongful Foreclosure?* <http://www.propublica.org/blog/item/primer-what-is-a-wrongful-foreclosure> (posted Nov. 24, 2010, 11:35 a.m.) (listing the many ways errors occur, including when a foreclosure starts on a homeowner who is not behind on his or her payments).

23. See Wang, *supra* n. 22 (noting that "processing errors" are one category of bank error). For a discussion of mortgage-servicing transfers generally, see 24 C.F.R. Section 3500.21 (2012).

behind.<sup>24</sup> Ultimately, the missing records and the banks' misapplication of proper payments triggered the computerized filing of a foreclosure suit. In this case, the lender's attorneys preferred to dismiss the suit and effectively remove themselves from the case, rather than attempt to work with the bank to correct the error.<sup>25</sup> A case like this, where the homeowner had strong defenses and counterclaims, was better addressed through normal litigation rather than judicial equitable discretion.

This Article addresses these types of potentially avoidable foreclosures where a homeowner has few legal avenues in which to pursue a dismissal of the case and reinstatement of the loan but wishes to and can afford to keep his or her home. This Article discusses how courts and lenders can deal with the cases where neither the lender nor the homeowner has committed any grievous malfeasance, the homeowner lives in and wants to continue living in the home, any missed payments were caused by a bona fide hardship, and the homeowner is willing to pay some portion of the debt. This Article addresses equitable remedies, so it only considers cases where a lender can establish every element of a prima facie foreclosure suit or, in a non-judicial state, has strictly complied with the mortgage or deed of trust's requirements. Because the foreclosure crisis is large and broad, the proposals in this Article are intended as partial solutions to specific cases rather than a one-size-fits-all solution to the crisis.

### B. Why Is There a Foreclosure Crisis?

One factor that makes equitable solutions particularly applicable today is the origination and structure of the current foreclosure crisis. The Great Recession brought two waves of foreclosure suits. The first was the collapse of the designed-to-fail mortgages frequently arranged by unscrupulous mortgage bro-

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24. For an example of loss-mitigation procedures, see Bankr. S.D.N.Y., *Southern District of New York Loss Mitigation Program Procedures* (published to be effective Dec. 30, 2010) (available at <http://www.nysb.uscourts.gov/pdf/lossmit/RevisedLossMitigationProcedures.pdf>).

25. For a detailed example of a homeowner almost facing foreclosure as a result of a bank error and the bank's initial reluctance to correct its error, see James Eli Shiffer, *Help Retracted by Bank Error*, <http://www.startribune.com/investigators/107775738.html?page=all&prepage=1&c=y#continue> (updated Nov. 15, 2010) (describing a bank error that was only corrected after news reporters contacted the bank about the story).

kers.<sup>26</sup> These “doomed to foreclosure” mortgages may have been payable or refinable if property values increased, but became impossible to pay as soon as home value peaked.<sup>27</sup> Homeowners obtained some of these loans under fraudulent pretexts, while lenders simply made others with wholesale disregard for a borrower’s ability to repay the debt.<sup>28</sup> By the time these loans reached the courts, the mortgage broker was long out of the picture. Generally, the lender who dealt with the mortgage broker was likely also gone.

The unemployment crisis caused the second wave of foreclosures.<sup>29</sup> Families suffered an involuntary reduction in income, which frequently resulted in an inability to pay the mortgage.<sup>30</sup> Many of the clients seen at the Authors’ offices once earned incomes above the area median but were laid off. After that, they were forced to try to make ends meet on unemployment compensation or on lower-wage work.

Whether the issue is predatory lending or simply a widespread, unforeseen financial catastrophe, homeowners facing foreclosures are likely to be victims of circumstances beyond their control. The question is how a court should minimize and distribute the various losses without a tortfeasor.

### C. The Homeowner

#### 1. *Who Is the Homeowner?*

There is no single portrait of the borrower facing foreclosure. As an example, a borrower who invested in a rental property or vacation home may no longer wish to retain the home after finances tighten or the investment sours. Other homeowners the Authors have spoken with have determined that they do not want

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26. See Robin S. Golden, *Building Policy through Collaborative Deliberation: A Reflection on Using Lessons from Practice to Inform Responses to the Mortgage Foreclosure Crisis*, 38 *Fordham Urb. L.J.* 733, 742 (2011) (discussing how the initial increase in foreclosures was related to sub-prime mortgages).

27. *E.g. Cmmw. v. Fremont Inv. & Loan*, 897 N.E.2d 548, 554 (Mass. 2008).

28. Prentiss Cox, *Foreclosure Reform Amid Mortgage Lending Turmoil: A Public Purpose Approach*, 45 *Hous. L. Rev.* 683, 692 n. 48 (2008).

29. Golden, *supra* n. 26, at 734.

30. See James H. Carr & Katherine Lucas-Smith, *Five Realities about the Current Financial and Economic Crises*, 44 *Suffolk U. L. Rev.* 7, 11–12 (2011) (discussing high unemployment and its contribution to the increase in foreclosures).

to retain their homes because they cannot afford necessary repairs or their health has deteriorated. As one homeowner put it, “the fight’s gone out of me.” This Article will focus on the homeowners who are committed to living in their home for the foreseeable future.<sup>31</sup>

Because many homeowners facing foreclosure cannot afford attorneys, a large percentage of them proceed pro se.<sup>32</sup> Though judicial foreclosure states are set up to allow homeowners to speak to a court in their defense,<sup>33</sup> those homeowners who successfully manage to answer a foreclosure complaint generally have trouble presenting properly authenticated evidence to oppose a summary judgment.<sup>34</sup> More often, they are so overwhelmed and intimidated by the legal system that they do nothing, and a lender can obtain a default judgment with little effort.<sup>35</sup> Due to the average homeowner’s lack of knowledge of the court system, even judicial foreclosure is most often an abbreviated process.

While the Authors of this Article have seen borrowers walk away from homes because they were frustrated with the lenders’ collection efforts, because financial strain fractured their personal relationships, or because they believed saving the home was

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31. See Cox, *supra* n. 28, at 711 (describing the importance of a homeowner’s emotional attachment to his or her home). Cox notes:

The family may be rooted in the house where they are raising their children, the neighborhood where they have found a sense of belonging, or a home they built. These familial or emotional attachments to a home can be of overwhelming importance to borrowers. Investors and commercial borrowers can be presumed typically not to have such attachments, but rather to treat their decisions in foreclosure solely as a matter of financial interest.

*Id.*

32. An American Bar Association survey of state trial judges indicates that the down economy has increased the number of pro se litigants in foreclosure cases. Terry Carter, *ABA Journal, Judges Say Litigants Are Increasingly Going Pro Se—At Their Own Peril*, [http://www.abajournal.com/news/article/judges\\_say\\_litigants\\_increasingly\\_going\\_pro\\_se--at\\_their\\_own\\_](http://www.abajournal.com/news/article/judges_say_litigants_increasingly_going_pro_se--at_their_own_) (July 12, 2010).

33. See Anthony Pennington-Cross, *The Value of Foreclosed Property*, 28 J. Real Est. Research 193, 200 (2006) (noting that judicial foreclosures must proceed through the court system, whereas lenders in non-judicial foreclosures may evict the homeowner and sell the property without using the court system).

34. See e.g. N.J. Cts., *How to File an Answer to a Foreclosure Complaint* 5, [http://www.judiciary.state.nj.us/prose/11380\\_foreclosure\\_ans\\_prose.pdf](http://www.judiciary.state.nj.us/prose/11380_foreclosure_ans_prose.pdf) (Feb. 2010) (explaining that New Jersey courts require an answer to contain every defense that a borrower has against the lender’s foreclosure claim).

35. Carter, *supra* n. 32 (noting that self-representation is often unsuccessful because pro se litigants commonly fail to present necessary evidence).

impossible and wanted closure, none of these fit the model of a traditional strategic default.<sup>36</sup> If strategic default is at all common, it likely is most common in areas with a significant housing bubble.<sup>37</sup> Homeowners attach value to their homes aside from just a monetary investment, and in the midst of a massive foreclosure crisis, our judicial system needs to be able to protect the value they attach to those properties.

## *2. Damages from the Homeowners' Perspective*

Homeowners' losses are more diverse and more difficult to quantify than lenders' losses. If homeowners have any equity in their home, they may suffer a financial loss.<sup>38</sup> For those homeowners with low incomes, homes represent their most significant and possibly only major investment. Even without home equity, a deficiency judgment could wipe away additional assets.<sup>39</sup> Notably, while the home will sell at a substantially reduced price

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36. Literature on the foreclosure crisis often discusses questions of strategic default, in which hypothetical homeowners walk away from their home (hopefully leaving the keys in the mailbox) not because they cannot afford to pay the mortgage but because they think the mortgage is a poor use of their money. See Cox, *supra* n. 28, at 699 (describing how lenders are often able to obtain default judgments because borrowers fail to take action in their case); see generally Luke Mullins, *Strategic Defaults and the Foreclosure Crisis*, U.S. News & World Rpt. (Jan. 19, 2010) (available at <http://money.usnews.com/money/personal-finance/real-estate/articles/2010/01/19/strategic-defaults-and-the-foreclosure-crisis>) (discussing how it is popular to walk away from a mortgage and why doing so might benefit the homeowner). In practice, it is rare for homeowners to think about the loss of their home as nothing more than a question of financial math. In the Authors' experience, many borrowers who report that they "are considering walking away" may be "considering" default primarily because their payments are so unsustainable that they do not have other options but would prefer to think of it as a strategic decision rather than a financial defeat.

37. See Neil Bhutta, Jane Dokko & Hui Shan, *The Depth of Negative Equity and Mortgage Default Decisions* 1–2 (Fed. Reserve Bd., Working Paper No. 2010-35, 2010) (available at <http://www.federalreserve.gov/pubs/feds/2010/201035/index.html>) (asserting that the median borrower will not strategically default until negative equity reaches sixty-two percent of value).

38. George McCarthy, Shannon Van Zandt & William Rohe, *The Economic Benefits and Costs of Homeownership: A Critical Assessment of the Research* 30 (Research Inst. Hous. Am., Working Paper No. 01-02, May 2001) (available at [http://www.housingamerica.org/RIHA/RIHA/Publications/48517\\_RIHAWp01-02.pdf](http://www.housingamerica.org/RIHA/RIHA/Publications/48517_RIHAWp01-02.pdf)).

39. A deficiency judgment requires the borrower to compensate the lender for any debt not covered by the foreclosure sale's proceeds. Andra C. Ghent & Marianna Kudlyak, *Recourse and Residential Mortgage Default: Theory and Evidence from U.S. States* 1 (Fed. Reserve Bank Richmond, Working Paper No. 09–10, July 7, 2009) (available at [http://www.fhfa.gov/webfiles/15051/website\\_ghent.pdf](http://www.fhfa.gov/webfiles/15051/website_ghent.pdf)). States that allow deficiency judgments often impose limitations that raise lenders' legal costs in pursuing the judgment or that result in a reduced recovery. *Id.* at 4.

in an already grim market, the amount due and owed will not decrease.<sup>40</sup> When a house sells for less than the amount owed, the homeowner's financial losses mirror those of the bank, though a homeowner may be less able to absorb these losses.<sup>41</sup> The homeowner has an additional set of damages as well.

The homeowner (most obviously, and perhaps most significantly) loses a home. Due partially to tighter underwriting standards,<sup>42</sup> but mostly due to damaged credit from the foreclosure process,<sup>43</sup> most borrowers cannot simply buy a new (presumably less expensive) home. Damaged credit may also affect borrowers' ability to rent a new home.<sup>44</sup> Of course, borrowers who have lived in a home for decades or watched children grow up in a home lose more than money and shelter.

While it is difficult to quantify the psychological damage caused by mortgage foreclosure, we have a partial window into this harm's magnitude through studies examining the health effects of foreclosures on communities.<sup>45</sup> Marriages rupture.<sup>46</sup> Both physical and mental health hospitalizations increase, particularly in minority communities.<sup>47</sup> Violent crime increases.<sup>48</sup>

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40. *Id.* at 1 (demonstrating that the homeowner is still liable to the lender for any remaining debt after the foreclosure sale).

41. Admittedly, some of the homeowner's losses may be theoretical. If the homeowner is so far in debt that a multi-thousand dollar judgment does not make a measurable difference, the financial loss to the borrower may be less than that of the bank.

42. Ltr. from Nat'l Foreclosure Prevention & Neighborhood Stabilization Task Force, to Dep't of the Treas. Off. of the Comptroller of the Currency, Bd. of Gov. of the Fed. Reserve Sys., Fed. Deposit Ins. Corp., Sec. & Exch. Comm'n, Fed. Hous. Fin. Agency, Dep't of Hous. & Urb. Dev., *Letter about the Dodd-Frank Wall Street Reform and Consumer Protection Act* (July 27, 2011) (available at <http://www.sec.gov/comments/s7-14-11/s71411-163.pdf>) (expressing the National Foreclosure Prevention and Neighborhood Stabilization Task Force's concern that stricter underwriting standards will make it difficult for many individuals to buy a new home).

43. McCarthy, Van Zandt & Rohe, *supra* n. 38, at 30 (noting that foreclosure is damaging to the borrower's credit).

44. *Id.* (explaining that homeowners who have filed for foreclosure often have difficulty renting homes because of damaged credit).

45. See Currie & Tekin, *supra* n. 11, at 3–4 (finding an increase in hospitalizations for anxiety, suicide attempts, and hypertension in zip codes with high rates of foreclosure).

46. See W. Bradford Wilcox, *The Great Recession's Silver Lining? The State of Our Unions* 15–16 (Dec. 2009) (available at [http://www.virginia.edu/marriageproject/pdfs/Union\\_11\\_25\\_09.pdf](http://www.virginia.edu/marriageproject/pdfs/Union_11_25_09.pdf)) (explaining that foreclosures can cause marital problems and potentially lead to divorce).

47. James H. Carr, Katrin B. Anacker & Michelle L. Mulcahy, *The Foreclosure Crisis and Its Impact on Communities of Color: Research and Solutions* 5 (Nat'l Community Reinvestment Coalition Sept. 2011); see also Currie & Tekin, *supra* n. 11 (discussing the increased rate of health problems in areas with high foreclosure rates).

Individuals are stigmatized and socially isolated.<sup>49</sup> Foreclosure may force individuals out of communities and away from their established support networks.<sup>50</sup> Because the loss of a primary residence is an event that causes irreparable harm, values of fairness are of utmost importance to homeowners.

#### D. Damages from the Lender's Perspective

##### 1. *Who Is the Lender?*

The party seeking foreclosure also has an interest in the process' result. Identifying who is seeking foreclosure in today's system, however, requires further explanation. Because of the steady devaluation of property,<sup>51</sup> acquiring a house through foreclosure seems like a bad investment by a bank. This is because a securitized loan's complicated structure creates a system where a party seeking foreclosure might appear to act against its own financial interests or may in fact act against its own financial interests.

Currently, most outstanding mortgages are securitized, which means that the party seeking to foreclose on a securitized mortgage is not a unified entity with monolithic interests.<sup>52</sup> As an example, the named plaintiff in a foreclosure action may be "U.S. Bank N.A., as Trustee for the registered holders of Structured Asset Securities Corporation, Mortgage Pass-Through Certifi-

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

49. See Brent T. White, *Underwater and Not Walking Away: Shame, Fear, and the Social Management of the Housing Crisis*, 45 Wake Forest L. Rev. 971, 972 (2010) (noting that homeowners fear the "shame or guilt associated with foreclosure").

50. Levitin & Twomey, *supra* n. 8, at 6 (explaining that foreclosure severs many social ties by forcing families to move out of their communities).

51. John McIlwain, *Housing in America: The Next Decade* 3 (Urb. Land Inst. 2010) (available at <http://www.uli.org/~media/Documents/ResearchAndPublications/Fellows/McIlwain/HousinginAmerica.ashx>) (noting that the housing market is in a "state of turmoil" and that home prices have fallen twenty-eight percent since their peak in 2006).

52. Mortgage securitization is the process in which mortgage loans "are sold by the original lender (typically through middleman financial institutions) to trusts that finance the purchase through the sale of bonds." Levitin & Twomey, *supra* n. 8, at 6 (describing how the process of mortgage securitization results in differing economic interests); see also Super, *supra* n. 3, at 109 (noting that mortgage securitization causes divergent interests, which makes it highly unlikely that all of the parties will agree to a "workout").

cates, Series 2005-SC1 c/o Ocwen Loan Servicing, LLC.”<sup>53</sup> This named plaintiff actually includes the interests of at least four different entities. Each entity must attempt to protect its interests in the case of a mortgage default.

The first entity, U.S. Bank, is a trustee and, purportedly, holds legal interest in the note and mortgage.<sup>54</sup> The second entity, the trust itself, is the “nominal beneficial owner of the loans.”<sup>55</sup> The third entity is the registered holders, who were the creditors of the trust.<sup>56</sup> In this example, they are the true beneficial owners of the loans.<sup>57</sup> For the sake of simplicity, these first three entities may be referred to as “the Investors.” While their interests may not be entirely in harmony, the Investors generally hope to receive a return on their investments. Here, they wish to receive either as much money as possible paid through the mortgage loan or a high recovery after a foreclosure sale. As all of these entities are the named plaintiff, an effort by the legal system to protect the foreclosure plaintiff’s interests should presumably focus on protecting these investors’ financial interests.

The fourth entity named as the party seeking foreclosure, “c/o Ocwen Loan Servicing,” is the servicing agent, or mortgage servicer, for the Investors. The mortgage servicer is responsible for all contact with the homeowner and the homeowner’s account.<sup>58</sup> This includes seeking a foreclosure.<sup>59</sup> Thus, though the Investor’s financial interests are at stake, the mortgage servicer makes decisions regarding a mortgage account and foreclosure. This divides the plaintiff’s decision-making and those most interested in protecting the financial investment that a mortgage represents.

Additionally, though the mortgage servicer does not technically own the loan, it is the party responsible for negotiation

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53. *E.g.* Aff. Pursuant to Rule 3129.1 at ¶ 3, *U.S. Bank N.A. v. Unknown Heirs* (Pa. Phila. Co. Ct. Oct. 2007) (No. 002516 Oct. 2007) (on file with *Stetson Law Review*).

54. Written Test. of Adam J. Levitin, H. Fin. Serv. Comm., Subcomm. on Hous. & Community Opportunity, *Robo-Signing, Chain of Title, Loss Mitigation, and Other Issues in Mortgage Servicing*, 111th Cong. 5 (Nov. 18, 2010).

55. *Id.*

56. *Id.*

57. *Id.*

58. See Levitin & Twomey, *supra* n. 8, at 23 (noting that the mortgage servicer is responsible for performing all routine tasks relating to the mortgages, including handling defaulted loans and prosecuting foreclosures).

59. *Id.*

regarding default.<sup>60</sup> Because of the structure of servicer compensation, the servicer's interests may frequently conflict with the Investors' interests.<sup>61</sup> This structure frequently prevents the party attempting to negotiate regarding a default from having the power, interests, or knowledge needed to arrange a settlement.<sup>62</sup> In the Authors' experience, the loan servicer often answers discovery requests rather than the named party.<sup>63</sup> While the servicer is, at least formally, an agent of the Investors, the servicer's decisions may not always reflect this agency.<sup>64</sup>

## 2. *What Does the Lender Want—and Why?*

Unlike most homeowners, servicers' and investors' interests in a foreclosure suit are financial. But the Great Recession has dramatically decreased this monetary interest's expected value. Due to declining home values, the recovery at a foreclosure sale is unlikely to match the amount due. Lenders may anticipate losses exceeding fifty percent of their investment if a property goes to sale.<sup>65</sup> In practice, the lender is likely to be the only party to bid on the property at foreclosure sale—for a fraction of market price.<sup>66</sup> In states that allow deficiency judgments, a lender may get a monetary judgment on the note—though as a rule, borrowers facing foreclosure due to financial hardship rarely have

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60. See Diane E. Thompson, *Foreclosing Modifications: How Servicer Incentives Discourage Loan Modifications*, 86 Wash. L. Rev. 755, 765 (2011) (noting that servicers are responsible for decisions about foreclosure and contacting the homeowner).

61. See *id.* at 767–768 (explaining how servicers are paid and observing that there is a conflict between how servicers are compensated and investors' interests); see also Levitin & Twomey, *supra* n. 8, at 29 (finding that servicers base decisions on their own economic interests).

62. See Thompson, *supra* n. 60, at 772 (explaining that servicers often refuse to modify for their own benefit and to the detriment of homeowners).

63. In practice, the Authors of this Article have seen those seeking foreclosure argue in discovery disputes both that information known by the investor should be off-limits to discovery and that information in the possession of the servicer should be off-limits to discovery because the servicer was an (allegedly) unconnected third party. This particular sleight of hand could be extremely detrimental to pro se defendants without a strong understanding of the mortgage-servicing industry.

64. Thompson, *supra* n. 60, at 766.

65. Adam J. Levitin, *Resolving the Foreclosure Crisis: Modification of Mortgages in Bankruptcy*, 2009 Wis. L. Rev. 565, 568.

66. Cox, *supra* n. 28, at 701 n. 118 (explaining that the only people attending most foreclosure sales are the borrower, the lender, and the person administering the sale).

collectible assets.<sup>67</sup> Due to the magnitude of this loss, combined with low interest rates and a prolonged slump in home values, some alternative to foreclosure should be possible if the homeowner has some income and willingness to pay. In practice, this is not the case.

In practice, modifications helping borrowers repay their loans are less common, though their frequency is difficult to quantify due to rapidly shifting practices. A study using data through 2008 found that only three percent of seriously delinquent mortgages received modifications that lowered borrowers' monthly payments.<sup>68</sup> The study noted, however, a seven-to-eight-fold increase in modifications in the fourth quarter of 2008 over the first quarter of 2007.<sup>69</sup> Because the Home Affordable Modification Program (HAMP) did not begin until March 2009, a further increase in payment-reducing modifications would be expected since this study.<sup>70</sup> Servicer compliance with HAMP, however, has been inadequate.<sup>71</sup>

In addition to the investors' and servicers' legitimate financial interests, a number of other factors may be motivating their behavior. Investors and servicers may be more interested in efficiency and predictability than in a particular case's outcome.<sup>72</sup> Investors and servicers give strict protocols to attorneys filing foreclosure suits. Consequently, a party seeking foreclosure may seemingly act against its own financial interests in a specific suit because of the belief that aggregate efficiencies of rapid foreclosure will outweigh losses in any specific suit.<sup>73</sup> As the lender

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67. The Authors of this Article have yet to see a lender pursue a deficiency judgment.

68. Manuel Adelino, Kristopher Gerardi & Paul S. Willen, *Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization* 3, Policy Discussion Paper No. 09-4 (Fed. Res. Bank of Boston, July 6, 2009) (available at <http://www.bostonfed.org/economic/ppdp/2009/ppdp0904.pdf>).

69. *Id.* at 11.

70. Dept. of Treas., *Administrative Website for Servicers, Home Affordable Modification Program*, <https://www.hmpadmin.com/portal/programs/index.jsp> (accessed Aug. 1, 2012).

71. See 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, 771–772 (2010) (concluding that HAMP's reliance on servicers to voluntarily reach out to borrowers and alert them to possible relief through modification was problematic due to servicers' lack of enthusiasm for modifications).

72. Levitin & Twomey, *supra* n. 8, at 1, 28.

73. *Id.* at 28 (explaining that the efficient default management of a pool of loans is more important than the fate of any single loan).

deals with many foreclosures, a decrease in accuracy may be acceptable if it results in increased efficiency. Additionally, because large mortgage servicers tend to be national organizations, it is probable that in certain circumstances, servicers will adhere to national policies without regard for local realities.<sup>74</sup> Lenders may also be concerned that modifying struggling loans too easily will lead to higher default rates in performing the loans or that being too quick to modify a loan will diminish borrowers' incentives to work creatively to reinstate the loan.<sup>75</sup> Depending on perspective, one could call this either a concern about moral hazard<sup>76</sup> or a habit of playing chicken with people's homes. Finally, there have been suggestions that investors may have an interest in not recognizing their actual financial losses.<sup>77</sup> While these factors may motivate lenders' decisions, they are generally not the legitimate interests courts should take into account when faced with a specific case. The securitized system of mortgage foreclosure has become so complex that lenders often act against their own financial interests.

#### E. Damages to Communities

The lender and homeowner are not the only parties with interests at stake in a foreclosure suit, and in the face of a national crisis, the greater community should also be protected. Much has been written attempting to assign blame, or at least responsibility, for the foreclosure crisis.<sup>78</sup> It should not, however,

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74. Golden, *supra* n. 26, at 739–740 (discussing the standard national policy of servicers to evict tenants—even those in good standing—from properties once foreclosure is complete, regardless of the possible retention of the property's value with a good tenant).

75. See Robert H. Gourley Jr., *The Evolution of the Mortgage Modification Process*, in Eric A. Rosen et al., *Negotiating Mortgage Modifications: Leading Lawyers on Navigating the Negotiation Process and Understanding the Impact of the Current Lending Climate on Mortgage Modifications* 59, 73 (Thomson Reuters/Aspatore 2010) (available on Westlaw at 2010 WL 895246) (explaining that lenders are fearful that a perception that they are weak will create a flood of borrowers expecting modifications).

76. See e.g. *All Things Considered*, Radio Broad., “Financial Blogger on Ethics of Mortgage Modification” (Nat'l Pub. Radio Mar. 26, 2010) (available at <http://www.npr.org/templates/story/story.php?storyId=125229165>) (discussing the criticism of programs that “reward[ed] homeowners who bought and borrowed beyond their means”).

77. See Braucher, *supra* n. 71, at 736 (suggesting that modifications were not in the investors' economic self-interest).

78. See e.g. *The Subprime Meltdown: Causes, Consequences, and Solutions*, 4 J. Bus. & Tech. L. 257, 257–258 (2009) (indicating that “[m]any theories abound for the cause of this

be controversial to insist that third parties, such as family members, neighbors, and communities, bear no responsibility for the foreclosure. Nevertheless, the costs of a completed foreclosure extend beyond the direct parties to the loan.

### 1. *Costs to Families*

A lost home's costs are not limited to the family members who were a party to the note and mortgage. Children suffer when the family loses a home.<sup>79</sup> Extended family may be forced to choose between the increased costs and expense of welcoming relatives who endured foreclosure into their own homes or the guilt of having turned away or turned out their own relatives.<sup>80</sup> As mentioned before, the prolonged financial uncertainty that comes with a foreclosure case can break up marriages.<sup>81</sup>

### 2. *Local and Community Costs of Foreclosure*

Foreclosure has a devastating effect on many who are not a direct party to a foreclosure suit. Communities suffer—both by losing community members and by decreases in home values.<sup>82</sup> As properties sit empty, neighborhoods suffer blight.<sup>83</sup> Because foreclosures in moderate- to higher-income neighborhoods are less likely to cause prolonged home vacancies, the negative externalities of foreclosure sales tend to be concentrated in the most

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crisis”); Time, *25 People to Blame for the Financial Crisis*, <http://www.time.com/time/specials/packages/completelist/0,29569,1877351,00.html> (accessed Aug. 1, 2012).

79. Levitin, *supra* n. 65, at 569.

80. See Valerie Lafferty, *Multigenerational Housing: Old School or Powerful Game Changer?* 21 No.1 Experience 26, 27 (No. 1, 2011) (explaining that unexpected medical expenses or the loss of a spouse may force seniors into insolvency and out of their homes); see also Ian Yarrett, *You Will Be a Parent to Your Parents*, 154 Newsweek 64 (Aug. 31, 2009) (available on Westlaw at 2009 WLNR 16008191) (discussing the recent increase in multigenerational households and the potential impact of foreclosures on extended-family living).

81. See Stephanie Armour, *Foreclosures Take an Emotional Toll on Many Homeowners*, USA Today, [http://www.usatoday.com/money/economy/housing/2008-05-14-mortgage-foreclosures-mental-health\\_N.htm](http://www.usatoday.com/money/economy/housing/2008-05-14-mortgage-foreclosures-mental-health_N.htm) (May 14, 2008, 10:38 p.m.) (noting that psychologists are also linking alcohol and domestic abuse to foreclosure fears).

82. Levitin, *supra* n. 65, at 568–569.

83. See Cox, *supra* n. 28, at 693–695 (explaining that vacant and abandoned properties are “a ‘curse’ on the livability of a community” and often lead to arson and rodent infestations).

vulnerable neighborhoods.<sup>84</sup> Municipalities also suffer as vacant properties increase the cities' costs while decreasing property-tax revenue.<sup>85</sup> The foreclosure crisis has had a disproportionate impact on persons of color—and may wipe out fifteen years of gains for persons of color.<sup>86</sup>

#### F. Unequal Bargaining Power

Finally, the unequal bargaining power between lenders and homeowners should encourage judges to exercise their equity powers to help resolve cases in the foreclosure crisis. The inequality in expected damages, legal knowledge, and probable legal remedies between a lender and homeowner leads to unequal bargaining power and permits strategic behavior on behalf of lenders. For example, in the Authors' experience, lenders' attorneys frequently insist that borrowers must pay legal fees for costs that either (1) the lender never incurred or (2) are vastly over-inflated. If borrowers question these costs, the lender may threaten to proceed with the case, knowing that borrowers are unlikely to risk their homes in litigation over a few thousand dollars. This is the case even though, to many homeowners who end up in foreclosure, those few thousand dollars could represent two or three months of household income.<sup>87</sup> Additionally, because most homeowners do not have effective legal counsel, if a lender proceeds with a foreclosure, the homeowner may lose his or her home even if he or she has solid defenses to the foreclosure suit.<sup>88</sup>

To best accommodate the homeowner's divergent needs, the lender, and the community, it is time for courts to use the tools available to them to consider somewhat "out-of-the-box" solutions

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84. Immergluck & Smith, *supra* n. 48, at 854.

85. *Id.* at 853–854.

86. *See generally* Carr, Anacker, & Mulcahy, *supra* n. 47 (providing a comprehensive discussion of foreclosures' impact on minority communities, including a look at racial disparities in the credit market).

87. Press Release from U.S. Dep't of HUD & U.S. Dep't of the Treas., *Obama Administration Releases January Housing Scorecard* (Jan. 31, 2011) (available at <http://portal.hud.gov/hudportal/HUD?mode=disppage&id=HUDNo.11-010>) (finding a median annual income of approximately \$46,000 among borrowers in active permanent HAMP modifications).

88. *See* Carter, *supra* n. 32 (reporting a finding that the number of pro se litigants has been increasing, specifically in foreclosure cases, and that those litigants tend to have worse results in court than those with legal representation).

to the foreclosure problem. Historically, courts of equity were able to hear cases in which a petitioner had “no adequate remedy at law.”<sup>89</sup> As discussed below, equitable remedies developed over time to address fact-specific unfairness in lending and, more specifically, foreclosure cases. When courts of equity merged with state courts, state courts developed the jurisdiction to offer remedies outside the strict letter of statutory and common law to better protect all the interests at stake.

### III. HISTORICAL EQUITY

#### A. How Courts of Equity Developed Where There Was No Adequate Remedy at Law

The legal principal of equity transferred to the United States from medieval English common law.<sup>90</sup> In medieval England, a petitioner for equitable relief would take his issue to a court of equity, or court of chancery, when he had “clean hands” and “no adequate remedy at law.”<sup>91</sup> There, the Chancellor of England would hear the issue and make a decision based on fairness and equitable rules.<sup>92</sup>

Early courts of equity, then, were set up to take fairness or ethical considerations into consideration when a strict legal remedy was too harsh.<sup>93</sup> Even in the sixteenth and seventeenth century, actions on debts were often taken to courts of equity, and

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89. Manuel R. Valcarcel, *He Who Seeks Equity Must Find the Court Which Does Equity—The Current Jurisdictional Conflict*, 19 *Nova L. Rev.* 415, 421–422 (1994) (discussing the historic distinction between equitable relief and relief under the law).

90. Lawrence R. Ahern, III, *The Law of Debtors and Creditors* vol. 1, § 8:2 (Thomson Reuters 2011); Grant S. Nelson & Dale A. Whitman, *Real Estate Finance Law* §§ 1.2–1.3, 6–7 (3d ed., West 1994); see generally Bruce Wyman, *The Clog on the Equity of Redemption*, 21 *Harv. L. Rev.* 459, 459 (1908) (discussing the role that courts of equity played in resolving disputes between mortgagees and mortgagors attempting to redeem mortgages in default).

91. Valcarcel, *supra* n. 89, at 421–422.

92. See Ahern, *supra* n. 90, at § 8:2 (describing how the equity of redemption and the foreclosure decree evolved in the English courts); see also e.g. *Select Cases in Chancery*, 10 *Seldon Soc’y* 1, 96–98 (1896) (providing an example of a fourteenth-century dispute before the English chancellor between a “disinherited” mortgagor and a “scheming” mortgagee).

93. See James Barr Ames, *Lectures on Legal History and Miscellaneous Legal Essays* 105 (Harvard U. Press 1913) (explaining how the seventeenth-century English chancery adopted the view that an obligor must not “profit at the expense of the obligee by the mere accident of the loss” or destruction of the contractual instrument).

equitable decisions were influential in creating contract principles in United States common law.<sup>94</sup>

In early courts of equity, the chancellor's decisions could favor an obligee or obligor depending on the facts of the case. In medieval England, there were few remedies under law for an obligor based on the unfair practices of an obligee, so considerations of fairness often favored the obligor.<sup>95</sup> Under British law, a properly formed contract was generally legally binding despite the contract's manifest unfairness.<sup>96</sup> Thus, a contractual obligor turned to courts of equity, where the English Chancellor had the power to grant a permanent injunction against a debt collection based on the obligee's unjust actions.<sup>97</sup> Early English courts of equity established such equitable defenses as fraud,<sup>98</sup> illegality,<sup>99</sup> failure of consideration,<sup>100</sup> payment,<sup>101</sup> accord and satisfaction,<sup>102</sup> discharge of surety,<sup>103</sup> accommodation,<sup>104</sup> duress,<sup>105</sup> agreement not to sue, and acquiescence.<sup>106</sup> Many of these defenses found their way into English and American common law.

To the extent that a mortgage note exceeds both the collateral's value and the borrower's ability to repay, the financial loss

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94. *Id.*; see also Nelson & Whitman, *supra* n. 90, at 6 (illustrating English equity law's profound effects on American mortgage law).

95. See Ames, *supra* n. 93, at 105 (explaining the "difference between the ethical attitude of equity and the unmoral (not immoral) attitude of the common law" with respect to the obligee's conduct).

96. See *id.* at 113 (noting the general rule that "the misconduct of the obligee in procuring or enforcing a specialty obligation was no bar at common law to an action upon the instrument").

97. *Id.* at 105–106 (explaining that the equity court would "furnish" the obligor with a defense by providing an injunction when strict enforcement of an obligee's rights would be "plainly unjust").

98. *Id.* at 106 (stating that from early on, equity courts "would grant a permanent unconditional injunction against" fraudulently obtained contracts).

99. *Id.* at 107 (remarking that common law courts historically would not uphold a contract that was patently illegal). Before 1767, however, common law courts would not void an agreement illegal or immoral in "its tenor." *Id.* In such cases, relief was only available through a bill in equity for an injunction. *Id.*

100. *Id.* at 108.

101. *Id.* at 109 (discussing the numerous cases in which a common law court required an obligor who failed to obtain and destroy a formal contract upon complete payment to pay the full amount due a second time).

102. *Id.* at 110–111.

103. *Id.* at 112.

104. *Id.*

105. *Id.* at 113–114 (noting that a claim of duress did not permit a grantor to recover property if the wrongdoer had conveyed the property to an innocent third party).

106. *Id.* at 114.

is unavoidable. But in many cases, the harms associated with displaced families can be avoided without further reducing the lender's expected recovery. Because mortgage servicers have thus far failed to adequately and voluntarily create solutions that keep homeowners in their home—even in cases when this causes little or no financial burden to the investor—the courts' role in avoiding displacement is of utmost importance. Research shows that families that enter the foreclosure process in judicial foreclosure states are about twenty percent more likely to still be in their home two years later than families in non-judicial foreclosure states.<sup>107</sup> Through judicious use of the equitable discretion invoked when a lender seeks foreclosure as a remedy, courts may further reduce harms caused by foreclosure-induced displacement without creating any additional cost to the lender.

#### B. Establishing the Foreclosure Remedy through Courts of Equity

Before the advent of courts of equity, foreclosure was a strict legal remedy that favored the obligee.<sup>108</sup> English common-law mortgages began as land transfers from an obligor to an obligee to satisfy a monetary debt.<sup>109</sup> On the date that the obligor's debt was due, known as "law day," the law required the obligor to have paid the obligee in full.<sup>110</sup> If an obligor did not pay his debt on "law day," he would have no right to re-enter his land, and the obligee would own title to his land free and clear without any judicial assistance.<sup>111</sup> This was true even in clearly unjust cir-

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107. Raven Molloy & Hui Shan, *The Post-Foreclosure Experience of U.S. Households* 33 tbl. 2 (Fed. Reserve Bd., Fin. & Econ. Discussion Series, Working Paper Series No. 2011-32, May 2011) (available at <http://www.federalreserve.gov/pubs/feds/2011/201132/index.html>). This study does not address whether this lower displacement rate after two years reflects a decrease in displacement or simply, as the study's authors hypothesize, a delay in displacement. Further empirical research on this topic may be necessary. *Id.* at 26.

108. See Ahern, *supra* n. 90, at § 8:2 (explaining that prior to the intervention of the chancery courts, the slightest default by a mortgagor would result in absolute possession of the land by the mortgagee); see also Nelson & Whitman, *supra* n. 90, at 6–7 (noting that the mortgagee had the right of immediate possession, which allowed for the collection of rents and profits derived from the mortgagor's use of the property).

109. Ahern, *supra* n. 90, at § 8:2.

110. *Restatement (Third) of Property: Mortgages* § 3.1 cmt. a (1997); Ahern, *supra* n. 90, at § 8:2; Nelson & Whitman, *supra* n. 90, at 7.

111. *Restatement (Third) of Property: Mortgages* § 3.1 cmt. a.

cumstances, such as when the obligor did not pay his debt in full only because he could not find the obligee on “law day.”<sup>112</sup>

With the development of the courts of equity, obligors would seek the English Chancery’s intervention when the results of these arrangements were unfair, and through these courts’ intervention, both an equitable and legal interest were created in the land.<sup>113</sup> Thus, over time obligees were required to satisfy both the legal and equitable interest to take title to the land through foreclosure.<sup>114</sup>

Initially, the Chancery only allowed the obligor to assert equitable defenses when they were available to him.<sup>115</sup> If the obligor filed a bill in equity asserting these defenses, the equitable courts could fix the amount due and allow an obligor to redeem his property by ordering additional time for him to pay his debt.<sup>116</sup>

By the end of the seventeenth century, equitable courts had developed the right of redemption for mortgages, where the obligor was permitted to redeem his land if he could pay his mortgage debt’s total principal and interest within a reasonable time after it had come due.<sup>117</sup> This became known as the obligor’s equity of redemption, and the obligor developed an interest in the land based on any payments he had made. That interest is itself referred to as “equity.”<sup>118</sup>

This system made it difficult for obligees to legally determine the length of a reasonable time during the equity of redemption, so they appealed to the courts of equity, which created the remedy of foreclosure in response.<sup>119</sup> After a mortgage default, the court of equity would set a reasonable redemption period for the obligor.<sup>120</sup> If the obligor refused to redeem his debt during that period, then

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112. *Id.*

113. *Id.*

114. *Id.*

115. *Id.*

116. *Id.*; see also Wyman, *supra* n. 90, at 459–460 (discussing various lenders’ attempts to evade the equity of redemption); see generally Baxter Dunaway, *The Law of Distressed Real Estate* vol. 1–2, pt. D (Thomson Reuters 2011) (discussing foreclosure and the respective parties’ rights).

117. *Restatement (Third) Property: Mortgages* § 3.1 cmt. a; see Wyman, *supra* n. 90, at 460 (discussing how courts refused to allow attempts to restrict the right of redemption).

118. *Restatement (Third) Property: Mortgages* § 3.1 cmt. a.

119. *Id.*

120. *Id.*

both the legal and equitable title to the land vested in the obligee.<sup>121</sup>

Obligees, searching for a way around the equity of redemption, attempted to require obligors to waive their right to redemption, but equitable courts prohibited any restriction, or clog, on the right of redemption.<sup>122</sup> Thus, the English courts effectively mitigated the strict laws surrounding mortgages to provide an avenue for obligors to redeem their land. This process has found favor in American courts, which recognize the right to redemption.<sup>123</sup> Additionally, the foreclosure auction, another equitable provision, is part of the foreclosure process in most states.<sup>124</sup> Though a bank has foreclosed on land, it must be willing to outbid anyone else who wishes to bid on the land in an auction to possess title.<sup>125</sup> Ideally, this competitive bidding process mitigates any deficiency for the homeowner.<sup>126</sup>

### C. Equity in Modern American Courts

Eventually, the laws of civil procedure merged law and equity, and courts were given jurisdiction over both.<sup>127</sup> Today, a court that is called a “court of chancery” simply retains the name of courts that are, in most states, long deceased.<sup>128</sup> Courts today have jurisdiction over both law and equity, and they can exercise broad equitable powers.<sup>129</sup> Thus, as strict legal remedies do not adequately address the myriad of interests that must be protected in today’s foreclosure crisis, modern courts should use their broad equitable powers.

Though the legislature can, and should, attempt to mitigate the crisis through new legislation, history has shown that the judiciary can be more effective. The last major foreclosure crisis in

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121. *Id.*; see also Wyman, *supra* n. 90, at 460 (noting that courts declare void agreements in which a borrower has agreed never to claim redemption).

122. *Restatement (Third) Property: Mortgages* § 3.1 cmt. a.

123. *Id.*

124. *Id.* Vermont and Connecticut use strict foreclosure. *Id.*

125. *Id.*

126. *Id.*

127. See *e.g.* Valcarcel, *supra* n. 89, at 421–422 (discussing equity jurisdiction in Florida’s modern court system).

128. *Id.* at 422.

129. See *e.g.* Fed. R. Civ. P. 2 (stating, “There is one form of action—the civil action.”).

the United States took place during the Great Depression.<sup>130</sup> At that time, the legislature attempted to pass equitable laws to stem the tide of foreclosures.<sup>131</sup> From 1933 to 1944, many states passed statutes designed to mitigate the foreclosure epidemic.<sup>132</sup> But courts struck down many of these statutes, holding that they violated due process and impaired contracts.<sup>133</sup>

The judiciary had more luck sustaining equitable judgments despite challenges to the constitutionality of equitable relief, as judicial relief does not involve the serious constitutional questions raised by the legislature.<sup>134</sup> Because state courts have equitable jurisdiction, their decisions do not violate due process, and because the courts' decisions do not create laws, their decisions do not impair contractual obligations in violation of the contract clause.<sup>135</sup>

In one Utah case on a mortgage debt, *First Union Trust & Savings Bank v. Division State Bank*,<sup>136</sup> Judge Fisher's opinion took note of the foreclosure emergency during the Great Depression and, due to that crisis, ordered an equitable solution.<sup>137</sup> First, Judge Fisher issued a foreclosure stay.<sup>138</sup> Next, instead of applying traditional foreclosure remedies, he appointed the borrower quasi-receiver of the property under the court's control with instructions to apply his income to the debt until it was paid in full.<sup>139</sup> In his opinion, he remarked on the futility of foreclosing when the foreclosure's effect was only to further depress property values.<sup>140</sup> Though the appellate court overturned this decision, it

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130. *Mortgage Relief During the Great Depression*, 47 Harv. L. Rev. 299, 300–301 (1933) [hereinafter *Mortgage Relief*].

131. *Id.* Many state legislatures passed moratoriums on foreclosures, and some passed statutes extending the time for pleading, postponing the day for sale, and prolonging the period of redemption. *Id.* at 301. Some states passed laws that delayed or forbid deficiency judgments or required the security's value to be deducted from the deficiency. *Id.*

132. *Id.* at 301.

133. *Id.* at 301–302.

134. *Id.* at 306.

135. *Id.*

136. 272 Ill. App. 487 (1st Dist. 1933) (reversing and remanding the trial court's decision).

137. *Mortgage Relief*, *supra* n. 130, at 302.

138. *Id.*

139. *Id.*

140. *Id.*

was one example of a judge who saw a situation where a legal remedy was inadequate and exercised his equitable discretion.<sup>141</sup>

In another case, the trial court, in *Suring State Bank v. Giese*,<sup>142</sup> took into account the general lack of bidders at a foreclosure auction in 1933 during the Great Depression and produced an order that equated the auction sale price with the property's value.<sup>143</sup> Essentially, due to equitable considerations, the court refused to grant a deficiency judgment to the bank.<sup>144</sup> Though such efforts were met with varying degrees of success, several courts during that time period recognized their equitable powers and used them to right unfairness created due to the circumstances of the time and the inequities of foreclosure.<sup>145</sup>

Today, courts still recognize that they have the authority "to hear and determine *all legal and equitable remedies* necessary or proper for a complete determination of the rights of the parties,"<sup>146</sup> and that equity should be invoked when there is no legal remedy at law and fairness requires it according to the circumstances of the case.<sup>147</sup> In *United States v. Jensen*,<sup>148</sup> a foreclosure action was brought against Mr. Jensen for unpaid property taxes.<sup>149</sup> But Mr. Jensen lived with his elderly wife who suffered from terminal cancer, and he appealed to the court's equitable jurisdiction to allow her to live the remainder of her life in her home.<sup>150</sup> The court equitably balanced the harm to Mrs. Jensen against the government's interest in delinquent taxes.<sup>151</sup> Eventually, the court found that "a substantial likelihood, not a mere possibility, exists that an innocent third party, Celia Jensen, will be unduly harmed by a foreclosure sale of the entire property."<sup>152</sup> Thus, the court delayed the property's sale until Mrs.

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141. *Division State Bank*, 272 Ill. App. at 487.

142. 246 N.W. 556 (Wis. 1933).

143. *Id.* at 557–558.

144. *Id.* at 558.

145. *Mortgage Relief*, *supra* n. 130, at 302–306.

146. *Discover Bank v. Owens*, 822 N.E.2d 869, 874 (Ohio Mun. Ct. 2004) (quoting Ohio Rev. Code Ann. § 1901.13 (West 2004)).

147. *Id.*

148. 785 F. Supp. 922 (D. Utah 1992).

149. *Id.* at 923.

150. *Id.* at 925.

151. *Id.*

152. *Id.*

Jensen's "health improve[d] or she no longer live[d] in the house."<sup>153</sup>

While the civil rules no longer distinguish between equitable and civil actions, the courts' broad equitable discretion remains when a party seeks a judgment in foreclosure. A court's ability and obligation to weigh the equities when determining whether foreclosure is an appropriate remedy may vary from state to state. In Ohio, a foreclosure suit clearly invokes the court's plenary equitable jurisdiction.<sup>154</sup> The Court of Appeals of Ohio, Fifth District, has held that "[t]he simple assertion of the elements of foreclosure does not require, as a matter of law, the remedy of foreclosure."<sup>155</sup>

The current circumstances that we face call for an exercise of the plenary equitable jurisdiction historically established to provide alternate contractual remedies where there is no adequate remedy at law. This historical development shows the value that our judicial system places on land and just outcomes under the law. The extent and uniqueness of our modern foreclosure crisis calls for the judiciary to exercise these tools to create simple, just, and equitable solutions that help protect the interests of all affected.

While a judgment on a promissory note is an action in contract that adjudicates the financial obligations of the parties involved, a mortgage foreclosure judgment has an equitable nature as well. An unsecured monetary judgment can often be settled with a partial payment without court intervention when a borrower has difficulty paying. Yet a foreclosure judgment rarely settles out of court because of the lender's right to sell the homeowner's property. It is appropriate that the lender and the courts use their discretion given by the equitable nature of a foreclosure action.

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153. *Id.*

154. *Daves v. Murphy*, 197 N.E.2d 818, 820 (Ohio App. 10th Dist. 1963).

155. *Eq. Fed. Sav. & Loan Ass'n v. Hopton*, 1985 WL 7309 at \*2 (Ohio App. 5th Dist. Oct. 28, 1985).

*IV. COURTS MAY USE THEIR BROAD DISCRETION IN WAYS  
THAT WILL ALLEVIATE THE HARMS OF THE  
FORECLOSURE CRISIS*

Due to the circumstances of the Great Recession, courts should use their equitable powers in several ways to handle the challenge of our current economic situation and minimize waste. A court's equitable consideration may consist of two steps. First, the court may design processes and procedures to avoid unnecessary foreclosure suits or to facilitate settlement in suits that can be resolved without a court ruling. Should this effort fail, courts must weigh the equities of a particular case and issue a ruling. Because this ruling may create some irregularity in a system used to dealing with uniform and predictable instruments, courts may want to allow litigants as great an opportunity as possible to amicably resolve issues before issuing a judicial ruling. Excluding the final proposal in this Part, each of these proposals is intended to help keep the homeowner in his or her home by removing barriers to a settlement. The final proposal offers courts a way to give the homeowner and lender a final opportunity to resolve the dispute, while ensuring that the costs of the failure to compromise fall on the appropriate party.

A. Equitable Considerations before Filing

One possible approach is for courts to require plaintiffs to submit additional certifications and a settlement contact person at the time of filing to streamline genuinely uncontested foreclosures, reduce avoidable foreclosure filings, identify foreclosures that are likely to be contested if the borrower can figure out how to contest them, and free up court resources to focus on the suits that raise serious equitable concerns. Requiring these certifications *before* filing will reduce the court's burden and will ensure that judicial review results in a more just outcome.

Requiring plaintiffs to provide certifications and contact information could also encourage settlement before the filing of a foreclosure suit. Such settlements would benefit the lenders by allowing them to avoid the costs and time of foreclosure. Settlement before filing also benefits the borrowers by preventing thousands of dollars in fees and interest that often accrue when settlement occurs simultaneously with a foreclosure suit.

Various courts across the country have implemented a number of similar pre-filing certification and information requirements. The Court of Common Pleas for Lucas County, Ohio has implemented General Rule 8.02(B), which requires that any filing for foreclosure be accompanied by a special designation sheet.<sup>156</sup> The rule says, “By submitting the case designation sheet, the attorney shall affirm that the name and direct telephone number of an individual with authority to reach a settlement in the matter is available upon request by a party or their legal counsel.”<sup>157</sup> It is often difficult for a homeowner or a homeowner’s attorney to reach a person with settlement authority for the lender. Because the designation sheet requires a signature, it may invoke Ohio Civil Rule 11, providing for penalties for false certifications if an attorney is not able to provide that name and direct phone number.<sup>158</sup>

Courts may also require specific loss-mitigation efforts before filing. For example, the South Carolina Supreme Court requires a review to determine whether a borrower is eligible for modification under the HAMP.<sup>159</sup> Requiring an accurate HAMP review as a partial equitable consideration is discussed below in Part IV(B)(3). The Connecticut Superior Court has implemented a similar requirement, mandating a more detailed loss-mitigation affidavit.<sup>160</sup> This affidavit requires lenders to certify that the borrower facing foreclosure is not eligible for a variety of existing loss-mitigation procedures.<sup>161</sup> The Connecticut affidavit is a particularly effective tool, as it requires the lender to list loss-mitigation efforts.<sup>162</sup> This requires the lender’s employee to pause and, hopefully, consider whether a foreclosure makes sense under the totality of the circumstances.

An additional equitable requirement for filing would be to require lenders to certify that they arranged an in-person meeting

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156. Lucas Co. Common Pleas Ct. Gen. R. 8.02.

157. *Id.*

158. Ohio R. Civ. P. 11.

159. Admin. Or. Re: Mortg. Foreclosures and the Home Affordable Modification Program (HMP), <http://www.judicial.state.sc.us/courtOrders/displayOrder.cfm?orderNo=2009-05-22-01> (S.C. May 22, 2009) (No. 2009–05–22–01).

160. Foreclosure Standing Or., Fed. Loss Mitigation Programs, [http://www.usfn.org/AM/Template.cfm?Section=USFN\\_E\\_Update&Template=/CM/ContentDisplay.cfm&ContentID=16348](http://www.usfn.org/AM/Template.cfm?Section=USFN_E_Update&Template=/CM/ContentDisplay.cfm&ContentID=16348) (Conn. Super. Aug. 4, 2010) (No. JD–CV–117).

161. *Id.*

162. *Id.*

with a homeowner before filing. This requirement would be similar to regulations surrounding mortgage loans insured by the federal government.<sup>163</sup> When the Federal Housing Administration (FHA) insures a mortgage loan, lenders are required to make a reasonable attempt to conduct a face-to-face meeting with borrowers before initiating a foreclosure suit, and if they do not, courts have dismissed suits based on a failure to complete the interview as a condition precedent to foreclosure.<sup>164</sup> State courts might model pre-filing requirements based on these FHA regulations. One of the largest complaints of homeowners who are sued in foreclosure is that when they began having trouble making payments, they were unable to have any meaningful communication with their lender regarding their circumstances or options.<sup>165</sup> If lenders are required to meet one-on-one in an interview or pre-foreclosure mediation with homeowners before initiating a suit, unnecessary suits could be avoided, which would save money for both parties.

Unfortunately, certifications are only useful to the extent that they are accurate. A requirement that lenders provide certifications before filing raises concerns about the much-discussed problem of robo-signing.<sup>166</sup> Legal investigations have discovered that lenders signed and submitted affidavits, frequently in support of motions for summary judgment, without reading or

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163. 24 C.F.R. at § 203.604(b).

164. *Id.*; see *Wells Fargo Bank v. Isaacs*, 2010 WL 4884447 at \*2 (Ohio App. 1st Dist. Dec. 1, 2010) (“under . . . HUD regulations, Wells Fargo could not commence foreclosure proceedings . . . until it had complied with the regulations”); *Wells Fargo v. Phillabaum*, 950 N.E.2d 245, 246 (Ohio App. 4th Dist. 2011) (holding that a bank must comply with all pertinent HUD regulations prior to initiating a foreclosure process); *U.S. Bank v. Detweiler*, 946 N.E.2d 777, 783 (Ohio App. 5th Dist. 2010) (following HUD regulations is a condition precedent to filing a foreclosure); *GMAC Mortg. of Pa. v. Gray*, 1991 WL 268742 at \*8 (Ohio App. 10th Dist. Dec. 10, 1991) (denying summary judgment for the Plaintiff because the failure to follow all servicing requirements established by HUD is an affirmative defense).

165. See U.S. Dep’t of HUD, *Avoiding Foreclosure*, [http://portal.hud.gov/hudportal/HUD?src=/topics/avoiding\\_foreclosure](http://portal.hud.gov/hudportal/HUD?src=/topics/avoiding_foreclosure) (accessed Aug. 1, 2012) (providing that homeowners should try to contact their lenders if a need for mortgage relief exists and indicating where to find information for assistance if they experience difficulty contacting a lender); see also 24 C.F.R. at § 203.604(b) (requiring the lender to attempt to arrange a meeting with the borrower, which could assist in improving communications).

166. Gretchen Morgenson & Andrew Martin, *Battle Lines Forming in Clash Over Foreclosures*, N.Y. Times A1 (Oct. 20, 2010) (available at <http://www.nytimes.com/2010/10/21/business/21standoff.html?pagewanted=all>).

reviewing them to ensure their accuracy.<sup>167</sup> This practice threatens the integrity of evidence before the court and is a symptom of a much broader problem. The problem is not simply that lenders have provided false testimony to the court to support a foreclosure judgment. The problem is that the foreclosure process has been broken down into so many pieces that no one employee feels moral responsibility for its effects or has the authority to compromise the process. By the time a foreclosure gets to the court, foreclosure attorneys, who are overwhelmed with a great volume of cases, seem to gloss over the problems rather than solve them. This leads, for example, to ambiguous pleadings stating, “The Plaintiff is the owner or servicer of the note” or “The original Note has been lost, misplaced, or destroyed.” When the lenders are challenged on these claims, the missing facts become clarified quickly—as if the lenders did not believe verifying them *before* filing was necessary.

## B. Equitable Considerations during Pending Foreclosure Suits

### 1. *Ensure Settlement Authority*

As discussed above, courts have used their equitable powers to facilitate resolution and settlement in foreclosure suits. This settlement effort is, in many cases, hampered by the difficulty in finding somebody with full settlement authority on the lender’s side.<sup>168</sup> Because the court has the power to compel individuals with settlement authority to appear before the court, or at a mediation, the court may exercise this power to facilitate the rapid resolution of certain claims. If, for example, the court determines that the unpaid principle balance claimed by the lender and income reported by the borrower support a loan modification, the court may require in-person attendance of an individual with settlement authority. Notably, any claim by a mortgage servicer that settlement is prevented by an “investor restriction” is simply an admission that the mortgage servicer does not have full settle-

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167. *Id.*; Associated Press, “Robo-Signing” of Mortgages Still a Problem, <http://www.cbsnews.com/stories/2011/07/18/national/main20080533.shtml> (July 18, 2011).

168. David A. Super, *Defending Mortgage Foreclosures: Seeking a Role for Equity*, 43 *Clearinghouse Rev.* 104, 104 (2009).

ment authority in any case where the named Plaintiff *is* the investor.

Because full settlement authority would require the authority—though, obviously, not the obligation—to release the entire debt, an individual with full settlement authority would likely be a person of significant status in a company. In at least one case, a court, having determined that the sole factor preventing settlement was the plaintiff's inability to procure an individual with settlement authority, ordered the company's CEO to appear at the next pre-trial conference if the case had not settled before that.<sup>169</sup> Needless to say, the case settled promptly.<sup>170</sup>

## 2. Mediation

In many courts, mandated or encouraged mediation has been used as an equitable device to encourage settlement while a foreclosure case is pending.<sup>171</sup> In some courts, a case in mediation is essentially taken off a judge's docket and placed on a "mediation docket" until it is determined that a case cannot settle.<sup>172</sup> If cases can voluntarily be resolved through mediation, the courts and homeowners save money. Because mediation brings a neutral third party in, it has significant potential to resolve large numbers of foreclosure cases, provided that all parties participate fully and in good faith.<sup>173</sup> Sometimes, however, the mediators do not have enough decision-making power to expedite the settlement process, and cases in mediation drag on while lenders continue to report that they need more documentation of homeowners' income in order to review them for a loan modification. Some, but not all,

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169. *US Bank NA v. Cox*, No. G-4801-CI-0201003578-000 (Ohio Com. Pleas July 18, 2011) (stating, "The Chief Executive Officer of US Bank N.A. and a loan analyst from US Bank N.A. must be personally present in Court").

170. One of the Authors was personally involved in this case.

171. Geoff Walsh, *Foreclosure Mediations: Can They Make a Difference?* 43 *Clearinghouse Rev.* 355, 355, 360–361 (2009).

172. This is the case in Lucas County, Ohio, where a foreclosure case in mediation is referred to the foreclosure magistrate for an indeterminate amount of time until one party decides that the case will not settle. See Charles D. Rittenhouse, *The True Costs of Not Paying Your Property Taxes in Ohio*, 36 *U. Dayton L. Rev.* 221, 244 (2011) (noting that Lucas County has hired a foreclosure magistrate to help mediate cases).

173. See Walsh, *supra* n. 171, at 358 (arguing that mediation programs may be the check on servicers that homeowners, especially those without attorneys, need).

jurisdictions require not only that parties mediate but that they mediate in good faith.<sup>174</sup>

Mediation efforts may fail when parties do not send representatives with full settlement authority. In foreclosure suits, this may mean that a lender sends a representative who simply informs borrowers that additional documents are required to verify a homeowner's income but has no knowledge of the facts or status of the case. More concerning, the lender may then attempt to collect its cost for this mediation from the borrower. In order to avoid this, courts may want to issue specific orders establishing a firm date before mediation by which a lender must request any documents it believes necessary for its review, as well as a firm date by which the borrower should submit these documents to the lender.

If the borrower has provided the requested documentation, but the lender is unable to discuss a modification without additional documents, mediators can then report that nobody with settlement authority came to mediation, permitting the courts to impose appropriate sanctions. Courts and legislatures may also want to determine whether mediation's generally strict confidentiality requirements serve their intended purpose in a foreclosure process. Foreclosure suits rarely have closely held secrets, and it would be easier to hold parties in foreclosure mediation accountable if actions taken during mediation sessions could be reported to the court. Additionally, courts may prohibit servicers from attempting to shift their costs of participating in the mediation to borrowers.<sup>175</sup> This prohibition is particularly important when repeated and expensive mediation sessions are necessary due solely to the lender's difficulty in reviewing documents in a timely fashion.

### *3. HAMP and Equity*

With the passage of the Emergency Economic Stabilization Act, Congress authorized the Treasury to create a program "to prevent avoidable foreclosures"<sup>176</sup> to accomplish the bill's stated

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174. *Id.* at 360.

175. *Id.* at 361.

176. 12 U.S.C. § 5219 (Supp. 2010).

goal of preserving homeownership.<sup>177</sup> Under this authority, the Treasury created the Home Affordable Modification Program.<sup>178</sup> While HAMP was anticipated to help three to four million at-risk homeowners “by reducing [their] monthly payments to sustainable levels,”<sup>179</sup> the actual results have been far less rosy. As of May 12, 2012, only 1,026,000 permanent modifications had been started.<sup>180</sup> The program has not accomplished its objectives.<sup>181</sup> While the program seems to have offered some help to the 816,833 people who received permanent modifications, another two or three million homeowners who *should* have received assistance under the program did not.<sup>182</sup>

Much of the failure of the program can be attributed to the mortgage servicers’ failure to comply with the program’s requirements. Mortgage servicers routinely failed to follow the borrower-solicitation requirements of the program,<sup>183</sup> miscalculated borrowers’ income,<sup>184</sup> and lost documents sent by borrowers.<sup>185</sup> Despite inconsistent application of HAMP guide-

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177. *Id.* at § 5201.

178. U.S. Gov’t Accountability Off., *Troubled Asset Relief Program: Results of Housing Counselors Survey on Borrowers’ Experiences with the Home Affordable Modification Program*, GAO-11-367R at 1 (May 26, 2011) (available at <http://www.gao.gov/new.items/d11367r.pdf>).

179. Home Affordable Modification Program, *Supplemental Directive 09-01: Introduction of the Home Affordable Modification Program 1* (Apr. 6, 2009) (available at [https://www.hmpadmin.com/portal/programs/docs/hamp\\_servicer/sd0901.pdf](https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/sd0901.pdf)).

180. U.S. Dept. of Housing & Urb. Dev. & U.S. Dep’t of the Treasury, *The Obama Administration’s Efforts to Stabilize the Housing Market and Help American Homeowners 2* (available at [http://portal.hud.gov/hudportal/documents/huddoc?id=junenat2012\\_scfinal.pdf](http://portal.hud.gov/hudportal/documents/huddoc?id=junenat2012_scfinal.pdf)).

181. See Braucher, *supra* n. 71, at 733 (discussing the minimal number of permanent modifications under HAMP from the program’s inception in April 2009 to early 2010).

182. U.S. Dep’t of the Treasury, *supra* n. 180, at 2.

183. See Written Test. of Mathew J. Scire, H.R. Comm. on Fin. Servs., Subcomm. on Ins., Housing & Community Opportunity, *Troubled Asset Relief Program: Actions Needed by Treasury to Address Challenges in Implementing Making Home Affordable Programs*, GAO-11-338T at 7 (Mar. 2, 2011) (available at <http://www.gao.gov/new.items/d11338t.pdf>) (describing the different ways that mortgage servicers solicit borrowers).

184. See U.S. Gov’t Accountability Off., *supra* n. 178, at 7–8 (discussing mortgage servicers’ miscalculation of borrowers’ income).

185. *Id.* at 4. A questionnaire distributed to housing counselors revealed that fifty-nine percent of housing counselors listed lost documentation among the three most common reasons why borrowers contacted them about HAMP. *Id.* By contrast, only thirty-two percent of housing counselors listed questions about the program or how to apply for it as a top reason why borrowers contact a housing counselor. *Id.* Furthermore, thirty-nine percent of the respondents who provided written comments stated that the borrower’s overall negative experience was due to documents that were “lost or needed to be resubmitted.” *Id.* at 5. Additionally, insufficient financial documentation, perhaps because servicers lost or

lines, the Treasury has not provided consistent remedies for HAMP non-compliance.<sup>186</sup> Courts in judicial foreclosure suits across the country, however, have held that compliance with HAMP directives is necessary before a judgment in foreclosure.<sup>187</sup>

Courts have acknowledged that requiring HAMP compliance before the initiation of a foreclosure suit is a sound public policy and wholly in line with courts' legal and equitable powers.<sup>188</sup> Because the HAMP program has a built-in Net Present Value test, it ensures that modification is only mandated in circumstances when it is in the note owner's financial interest.<sup>189</sup> In this program, a bank's insistence on foreclosure is against its own financial interests. Furthermore, the directives only apply when the party with a financial stake has consented to them.<sup>190</sup> Finally, the Dodd Frank bill has established HAMP compliance as the industry standard for mortgage servicing.<sup>191</sup> For these reasons, it is important that courts use their equitable jurisdiction to consider whether a lender complied with HAMP before foreclosure. If a loan is eligible for a HAMP modification but the lender seeks

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misplaced it, is one of the most common reasons that borrowers' trial modifications were cancelled. *Id.* at 8.

186. Written Test. of Mathew J. Scirè, *supra* n. 183, at 8.

187. *E.g. Deutsche Bank Nat'l Trust Co. v. Kane*, No. EQCV067273, slip op. at 3 (Iowa Dist., Mar. 31, 2010) (denying summary judgment when there was no evidence that the lender complied with HAMP); *U.S. Bank N.A. v. Bleckinger*, No. 10-CV-0095, slip op. at 7 (Ohio Com. Pleas, filed Oct. 13, 2010) (stating, "This Court finds that Defendant homeowners can reasonably be determined to have an affirmative defense in a foreclosure action when raising a loan servicer's non-compliance with HAMP"); *GMAC Mortg. LLC v. Riley*, No. 500-09 Fc, slip op. at 5 (Vt. Super., Mar. 5, 2010) (noting that the mortgage servicers have already covenanted that "all [HAMP] Services will be offered to borrowers, fully documented and serviced, or otherwise performed, in accordance with the applicable Program Documentation"); *HSBC Bank USA v. Searls*, No. 08-CV-328 (Wis. Cir., July 27, 2010) (requiring lender to produce a witness to explain why a loan was not permanently modifies after a successfully completed HAMP trial period).

188. *See supra* n. 187 (listing cases acknowledging the sound public policy); *see also* Rebekah Cook-Mack & Sarah Parady, *Enforcing the Home Affordable Modification Program through the Courts*, 44 Clearinghouse Rev. 371, 372 (2010) (discussing how courts enforce HAMP by allowing HAMP noncompliance as a defense to foreclosure suits).

189. Making Home Affordable Program, *Handbook for Servicers of Non-GSE Mortgages* 84–85, [https://www.hmpadmin.com/portal/programs/docs/hamp\\_servicer/mhahandbook\\_33.pdf](https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/mhahandbook_33.pdf) (Sept. 1, 2011).

190. *Id.* at 18.

191. Donald Lampe & Jonathan Kunkle, *Behind the Curtain: HAMP Workouts are More Successful When Servicers Rely on Technology*, *Mortg. Tech.* 8 (Apr. 2011) (available at <http://www.nationalmortgagenews.com/pdfs/MTApril2011.pdf>).

foreclosure anyway, the court may determine that foreclosure is simply inequitable.<sup>192</sup>

#### 4. Sanctions

Courts have been understandably reluctant to use widespread sanctions in foreclosure cases when a lender, or lender's attorney, acts in a way that is unfair to the homeowner or against the court's rules.<sup>193</sup> The nature of equitable jurisdiction, however, and of foreclosure actions, lends itself to sanctions as an appropriate equitable punishment. When determining whether sanctions are appropriate for failure to appear at a settlement conference with full authority or for failure to engage in discovery, courts may consider that any conduct uncovered in one case is likely present in hundreds of other cases due to the regimented nature of many foreclosure suits. While a borrower's attorney may recognize that, for example, the claim that copies of correspondence allegedly sent from the lender to the borrower is not discoverable on the grounds that it "was previously sent to the borrower" or "might be in the borrower's possession" is frivolous and should be contested, any borrowers proceeding pro se may be unable to identify and dispute such claims. Raising frivolous objections that do not represent a reasonable interpretation of the law to vulnerable pro se litigants misleads an opposing party in ways that may run afoul of ethical rules and calls for a response from the court system using its equitable jurisdiction.<sup>194</sup>

#### 5. Equitable Considerations at the Judgment Phase

As discussed above, most foreclosure suits should have some potential for a mutually preferable resolution. The measures listed above are designed to assist parties in reaching this resolution. These efforts, however, may still fail to secure a modi-

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192. See Cook-Mack & Parady, *supra* n. 188, at 372 (stating that courts have "broad authority to enforce the [HAMP] program through their equitable powers").

193. See e.g. Geoff Walsh, *The Finger in the Dike: State and Local Laws Combat the Foreclosure Tide*, 44 Suffolk U.L. Rev. 139, 163 (2011) (noting that "[t]o date, no Nevada courts have expressed a willingness to impose a loan modification as a sanction for a servicer's bad faith conduct in mediation").

194. See e.g. Model R. Prof. Conduct 3.1 (ABA 2011) (indicating that lawyers shall not raise frivolous claims or defenses).

fication, even in a case where the modification is preferable to foreclosure. For example, a lender may determine that its underwriting standards do not permit it to consider a non-traditional income source, even when the court considers this income sufficiently reliable to support a loan modification. Alternatively, a lender may simply refuse to work with a borrower. In such cases, a court may consider a judgment entry that aims to minimize losses due to foreclosure and divides the losses equitably between the parties.

When considering such an entry, the court may consider the homeowner's ability and willingness to make payments, the home's likely value, the probable harms to the community, and the parties' past conduct regarding loss mitigation.<sup>195</sup> If, for example, a servicer or investor declined to participate in HAMP, the court may prefer an equitable resolution to a traditional foreclosure judgment. On the other hand, if a borrower has rejected an offered modification or failed numerous affordable modifications, a court may determine that the equities weigh in favor of a foreclosure sale. Borrowers facing foreclosure frequently cannot afford counsel and may be unable to satisfy the formal requirements of presenting the court with an affidavit, so the best solution may be an in-person hearing on the equities.

Should a court determine that a lender is entitled to a monetary judgment on the traditionally legal action on the note, the court may nevertheless determine that a foreclosure judgment on the mortgage is inappropriate. Because irreparable harm to the borrower occurs with the loss of a home, the court may determine that an equitable distribution of the losses should not require a foreclosure of the mortgage. This might occur if the amount owed is low relative to the home's value, if the expected recovery at sale is relatively low due to the loan's size, or if the hardship on the homeowner is particularly severe. The court may be particularly inclined to pursue such an avenue if the lender has tied its own hands by contracts with third parties, refused to participate in national or state foreclosure-prevention programs, or engaged in a pattern of deceptive or negligent behavior in connection with ser-

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195. See Patrick Carey, *Loss Mitigation: Understanding the Fundamentals*, 71 *Mortg. Banking* 161, 161 (stating that the main factors are "the homeowner's financial condition, employment status[,] and the value of his or her home").

vicing the loan. The Supreme Court addressed the breadth of the judiciary's equitable power in *Precision Instrument Manufacturing Co. v. Automotive Maintenance Machinery Co.*<sup>196</sup>

The guiding doctrine in this case is the equitable maxim that "he who comes into equity must come with clean hands." This maxim is far more than a mere banality. It is a self-imposed ordinance that closes the doors of a court of equity to one tainted with inequity or bad faith relative to the matter in which he seeks relief, however improper may have been the behavior of the defendant. That doctrine is rooted in the historical concept of court of equity as a vehicle for affirmatively enforcing the requirements of conscience and good faith. This presupposes a refusal on its part to be "the abetter of iniquity." Thus while "equity does not demand that its suitors shall have led blameless lives," as to other matters, it does require that they shall have acted fairly and without fraud or deceit as to the controversy in issue.<sup>197</sup>

Courts may consider a judgment entry such as the following:

Upon consideration, this court finds that the defendant is liable on a promissory in the amount of \$XX.xx. This court has also determined that, at this point, a weighing of all relevant equitable considerations does not require the foreclosure of the mortgage securing this note due to the reduced value of the property; the defendant's ability and willingness to make payments on the debt; and the high probability of irreparable harm to the defendant, the defendant's family, and the defendant's community.

Should the Plaintiff desire to enforce this lien, the Plaintiff is directed to appraise this property, prepare a modified note reflecting a principal balance of the appraised value of this property (not to exceed the amount of the judgment above), a fixed interest rate not to exceed the Freddie Mac Primary Mortgage Market Survey at the date of this entry, and a thirty-year term.

Should the borrower either refuse to execute this note within thirty days of its tender or fail to remit payment as

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196. 324 U.S. 806 (1945).

197. *Id.* at 814–815 (internal citations omitted).

required by this note within three months of execution, the court will, upon motion by the Plaintiff, amend this order directing the sheriff to sell the property.

Because properties tend to sell at a much-reduced price at a foreclosure sale, a performing loan for the house's appraised value should put the lender in comparable position to where the lender would have been if it were permitted to take the property to sale. This order's practical effect would, of course, mimic the hotly debated mortgage cram-downs<sup>198</sup>—though any deficiency on the note would be owed but unsecured and presumably dischargeable in a later bankruptcy. The probability that the court will effectively impose a mortgage modification without equitable behavior could have some of the same effects that the availability of a bankruptcy cram-down would have. It could also bypass contractual prohibitions and other impediments that might prevent efficient modification.<sup>199</sup>

Adam J. Levitin and others have suggested permitting cram-down in Chapter 13 Bankruptcy as a solution to the mortgage crisis.<sup>200</sup> While this may work for many borrowers, Chapter 13 bankruptcy is impractical or inaccessible to much of the most vulnerable population.<sup>201</sup> Certain borrowers may be able to afford a house but may be unable to comply with the terms of a full five-year bankruptcy plan.<sup>202</sup> Unemployed borrowers may have a negative expected cash flow and would be better served if they could wait until they found steady employment to file bankruptcy.<sup>203</sup>

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198. A mortgage "cram-down" refers to a judge's modification of a mortgage loan, "often reducing principal so a borrower can afford it." Michael Corkery, *Mortgage 'Cram-Downs' Loom as Foreclosures Mount*, Wall St. J. C1 (Dec. 31, 2008). A cram-down may occur "because the house . . . is worth less than what is owed on it." Lew Sichelman, *Rekindling 'Cramdown' Debate*, 34 Nat'l Mortg. News 6, 6 (Sept. 13, 2010).

199. Levitin, *supra* n. 65, at 576.

200. *Id.*

201. See John Eggum, Katherine Porter & Tara Twomey, *Saving Homes in Bankruptcy: Housing Affordability and Loan Modification*, 2008 Utah L. Rev. 1123, 1126–1131 (discussing why bankruptcy may be a good option for families experiencing a temporary decrease in income, but also addressing why it is ill-suited for families who have experienced a prolonged decline in income prior to bankruptcy).

202. See *id.* at 1142 (stating that the "majority of chapter 13 homeowners . . . may find it difficult to keep up with the combination of ongoing housing payments, other expenses allowed under their chapter 13 plans, and their plan payments to repay creditors or cure mortgage arrearages").

203. See *id.* at 1147 (stating that "[f]iling chapter 13 while spending 90% or more of one's income on housing costs may be rational for a debtor whose income on the day of

Extremely low-income homeowners may not have the assets to pay for a Chapter 13 bankruptcy.<sup>204</sup> The possibility of principle reduction through bankruptcy, however, could conceivably incentivize lenders to offer borrowers mortgage modifications that include principle reduction without requiring a bankruptcy filing.<sup>205</sup> Just as the availability of a principle-reducing bankruptcy could incentivize voluntary modification, widespread use of the principle-reducing judgment entry could incentivize modification before a demand for judgment.

### V. CONCLUSION

Courts have been permitted to use equity to mitigate the effects of harsh lending laws for centuries. In particular, courts have often used equitable jurisdiction to mitigate the effects or process of mortgage foreclosure when debts are secured by people's homes, a security which has immeasurable, non-financial value to borrowers. A balance of the equities in today's Great Recession shows that courts should utilize their equitable jurisdiction in both new and time-honored ways to promote fairness and efficiency in foreclosure law.

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bankruptcy filing is an unemployment check but who is starting a higher paying job in a few weeks").

204. Because Chapter 13 requires a prolonged commitment from an attorney, finding a legal services or pro bono attorney to handle a Chapter 13 case may be impractical or impossible. Similarly, many extremely low-income individuals are in a position where they need to choose which recurring bills to pay with their limited income. Low-income consumers may choose to pay their mortgage to avoid foreclosure, pay the car note to avoid repossession of the car, and then need to choose whether to pay the phone bill or medical bills, depending on whether the consumer expects to need additional treatment from that particular provider. This situation would make the sort of budget necessary for a Chapter 13 bankruptcy nonviable. But while the inability to pay a phone bill may result in a loss of phone service, it should not require the loss of a home.

205. Marjorie B. Maynard, *Mortgage Cramdown in Bankruptcy as a Necessary Incentive to Encourage Mortgage Modifications*, 14 N.C. Banking Inst. 275, 282 (Mar. 2010).