# LITIGATION AND MITIGATION: CONSIDERATIONS FOR THE FORECLOSURE DEFENSE LAWYER

In recent times, the American dream has become a nightmare for many homeowners, and Florida has been among the most heavily-impacted by foreclosures.[i] Analysis of the crisis breaks down into two often-overlapping components: unaffordable mortgage payments and property values that are lower than the corresponding loans. The former results from a bad home loan[ii] or a financial hardship. The latter, known as being "upside down," stems from market forces. More often than not both scenarios apply to the client's situation, but the distinction remains important since these are the key factors in determining strategy.

Where the distressed property is the primary residence, the client will usually want to save the home if at all possible.[iii] In the case of a temporary financial hardship, the client can avoid foreclosure by simply reinstating the loan once the hardship ends. Too often, however, the property is saddled with a bad loan or the hardship is not expected to end soon. Refinancing would be a solution, but the majority of distressed owners do not qualify. That leaves the client with some combination of foreclosure defense and loan modification as the best option. As for upside-down investment properties, saving the home may be a losing proposition and the owner may not want[iv] to modify or refinance. In that situation, a short sale may be the most practical alternative.

Some people take an unsympathetic, rather moralistic view of one or both of these categories of homeowners, blaming them for poor decision-making and expecting them to endure the consequences rather than seek loss mitigation. Lawyers with this opinion are not the target audience here since they are better suited to representing lenders[v] rather than homeowners. Instead, the aim here is to provide an overview of the foreclosure process and highlight the interplay between defense and loss mitigation in order to enhance representation of clients whose properties are at risk.

## Foreclosure Defense

Once an owner misses a couple of mortgage payments, the lender will typically make certain communications, the most important of which is the notice of default. This letter is of particular significance since most mortgages contain an acceleration clause that is only triggered with proper notice.[vi] The next step is usually initiation of foreclosure proceedings.

Some have the impression that hiring a lawyer is unnecessary if the homeowner plans to pursue loss mitigation. The notion is that lenders are expected to suspend the lawsuit once the owner starts the process of modifying the home loan or lists the property for sale. This is wrong for two main reasons.

First, lenders are under no obligation to stop or slow foreclosure litigation in the face of loss mitigation and many of them will not. Each lender has its own personality and some even pay their lawyers more for expediting the foreclosure. This approach has its logic given that lenders may in certain regards improve their position by having the title to the property in hand. This may be especially true where the lender's case is prone to weaknesses such as a lost note or potential RESPA,[vii] TILA,[viii] or Florida Fair Lending Act[ix] violations. To be fair, some lenders do see financial advantages in cooperating with homeowners, even halting proceedings while loss mitigation is explored, but counting on such restraint is a dangerous play indeed.

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Second, loss mitigation of any sort is a negotiated process, and the key to any negotiation is leverage. Well-contested lawsuits are longer and more expensive to prosecute. If for no other reason than that, the represented homeowner is in a better position to work out terms with the lender. Moreover, if the owner successfully modifies the home loan, any advantage gained in negotiating terms, however small, is likely to mean significant savings over the life of the loan. The same is true for a short sale since the owner may be able to mitigate exposure to a deficiency judgment through negotiation. Seen from this perspective, a skillful defense lawyer is worth retaining at almost any price.

Without discounting the importance of legal representation, lawyers should avoid conveying the impression that foreclosure defense is a long-term solution. It is true that a good defense can be difficult for the plaintiff to overcome and may result in protracted litigation. Nonetheless, barring unusual circumstances, homeowners who are not making mortgage payments cannot—and probably should not—ultimately prevail in these actions. For this reason, pragmatic lawyers will recognize the necessity for loss mitigation in conjunction with foreclosure defense and advise the client accordingly.

Regarding ethics, there are a few issues that require attention. For example, some clients have no intention of mitigating loss and simply hire a lawyer to delay foreclosure as long as possible. Sometimes there are solid business reasons for this strategy. After all, the longer the suit is prolonged, the more time the client enjoys free housing or, even better, pockets rent money paid by tenants. When this or similar situations arise, the prudent lawyer should consider both the propriety of enabling a client in this way as well as the possibility of a tarnished image before the court.

In a similar vein, lawyers should determine early on just how far they are willing to take the defense and at what price. In other words, there are certain mechanisms available—mortgage audit, removal to federal court,[x] appeal, extensive discovery, etc.—that can bog down a case and probably benefit the client in one way or another.[xi] There are a few instances where these *additional* measures have led to either a favorable ruling for the defendant or voluntary dismissal by the plaintiff. Also, such measures may create additional leverage and facilitate a more favorable outcome to loss mitigation. Conscientious lawyers naturally feel obligated to pursue all avenues that may benefit the client, but there is more to the analysis here.

Consider legal services rendered as part of a *typical* defense. If hired early in proceedings, the lawyer will file an answer with affirmative defenses,[xii] thus preventing default and laying a foundation for overcoming plaintiff's inevitable motion for summary judgment. Then comes preparation for the summary judgment hearing, which includes filing a response in opposition[xiii] and, where indicated, initiating discovery. If the court denies the plaintiff's motion for summary judgment, the case must be set for trial, which will likely be some months later. If the plaintiff prevails on its motion for summary judgment, the defense lawyer can still request an extended sale date for the property.[xiv] Some courts have recently taken administrative measures to speed up this process, yet the suit can easily endure a year or more without employing any *additional* measures. It is hard to characterize such an effort as somehow inadequate. Moreover, where the strategy involves loss mitigation, the *additional* measures may not make sense financially.

After all, *additional* measures not only make actions much more expensive to prosecute but also more expensive to defend, and many clients are not willing or able to pay a fee that justifies the extra work. Some lawyers address this issue by charging a reoccurring monthly fee rather than an hourly rate or a simple fixed rate. The logic of this solution is undeniable and it does create the right incentives. If the

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presumption is homeowners do not pay their mortgages during the foreclosure action, then they should have some extra money available to pay the lawyer's fees. Moreover, by this approach, the lawyer is rewarded for employing *additional* measures and seeking all possible advantages for the client. This is an elegant solution in theory, but there are drawbacks in practice.

For one thing, the reality is that homeowners might make payments for a few months but then stop. The lawyer then has few options: neglect the file, work for free, or withdraw. Allowing the file to languish may be an ethical violation[xv] that leads to client discontent at best and malpractice at worst. Working for free is unrealistic. So, the best option is withdrawal. In that event, good intentions not withstanding, has the client been well served? Consider whether both parties might not be better off with a reasonable one-time fee for *typical* representation that sees the client through to the end.

**Loss Mitigation**

This article does not attempt to detail the steps involved in a loan modification, short sale, deed-in-lieu-of-foreclosure, or other work-out arrangement. Rather, the point here is to identify considerations relevant to lawyers and point out how the principle mitigatory mechanisms may be used in conjunction with foreclosure defense.

Loan Modification

In spite of much recent negative media attention, there seems to be increasing realization on the part of lenders and politicians that modification of existing loans may be the lesser of the available evils. Given expenses involved in foreclosure actions, management, maintenance, marketing, taxes, etcetera, most lenders have had their fill of re-acquiring properties. Worse still, foreclosure leaves the lender with a property that cannot be readily sold and/or that must be sold at a significant loss. Moreover, with President Obama's Making Home Affordable program,[xvi] which provides protections and incentives to lenders, modification is often the most financially sensible option—plus families get to keep their homes.

About two years ago, unregulated loan modification companies began to proliferate throughout the state and country in response to the demand for modifications. In October 2008, the perception of unscrupulous modification companies led state legislators to enact Florida Statute §501.1377.[xvii] The statute, *inter alia*, prohibits loan modification companies[xviii] from charging up-front fees for their services, which makes it almost impossible for such companies to be both compliant and profitable. Lawyers, however, are considered exempt from the statute,[xix] which perhaps gives rise to opportunity. Specifically, the statute creates a gap between the demand for loan modifications and the supply of entities that may viably provide the service.

Law firms are permitted to provide loan modification services and charge fees as they normally would. However, the process of modifying a loan is lengthy and tedious to the point that lawyers cannot easily provide the service in a cost-effective manner. The obvious solution is to outsource the work to loan modification companies, but be forewarned. Such relationships have received a shocking level of scrutiny from the Florida Bar Association and Attorney General's office.[xx] Such relationships probably can be formed and maintained in a manner that is compliant and

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proper under all rules of professional conduct, but there are pitfalls. For example, the lawyer must not fee-split or utilize a loan modification company to avoid rules against solicitation.[xxi]

One alternative is to bring the work in-house by setting up a loan modification department within the firm. Another is to simply limit services to foreclosure defense. Staying away from loan modification altogether avoids potential headaches but, at the same time, the lawyer should be wary of selling foreclosure defense as a long-term solution by itself since, in most cases, it is not. Rather, the defense lends to modification and vice-versa.

As earlier explained, a strong defense can motivate the lender to modify the loan, and some lenders will voluntarily suspend foreclosure proceedings while the homeowner is actively pursuing a loan modification. Also, although loan modification does not provide any pure legal defenses, some courts have demonstrated a clear preference for loss mitigation over foreclosure. For example, several counties have administrative orders[xxii] that require, or strongly encourage, the parties to consider some kind of workout.[xxiii] Moreover, many judges will grant extended judicial sale dates in order to give the homeowner time to attempt a workout with the lender.

A successful loan modification is in many ways the best possible outcome of a foreclosure suit. The client keeps the property with comparatively minimal consequences, and the bank mitigates its financial loss. Notwithstanding, there are situations where modification may be impossible or undesirable. For example, some clients' debt-to-income ratio will not fall within the lender's parameters for modification, or the property may just be too far upside-down to be worth saving. In such circumstances, the client can permit the property to be foreclosed, seek deed-in-lieu-of-foreclosure,[xxiv] or attempt a short sale. Each of these options has some utility, but most often a short sale is the best course of action.

Short Sales

Selling the property short, where possible, has a couple of advantages over losing the property via foreclosure. For example, a short sale has less overall impact on the client's credit history than does a foreclosure. Moreover, since short sales are negotiated, the client retains some level of control during the process, as opposed to foreclosure proceedings where the client is at the mercy of the court.

For the most part, realtors handle the short sales. However, some lawyers collaborate with realtors by offering short sale facilitation services, which may include counseling the client with respect to deficiency judgments and tax implications[xxv] as well as participating in negotiations with the lender. Even if the lawyer is not directly involved in the short sale process, collaboration with the realtor may still be necessary where the lender continues proceedings in spite of the realtor's efforts.

**Conclusion**

As a practice, foreclosure rescue has both business and emotional components. In the former regard, lawyers should thoughtfully weigh clients' desires against their financial capabilities and make recommendations accordingly. At the same time, the threat of losing a home often leads to an emotionally-charged situation, and lawyers need to be both sensitive to the client's dilemma and

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mindful of possible backlash. In all respects, best results can only be obtained where the client has a clear understanding of available options and counsel appreciates the reciprocal relationship between litigation and mitigation.

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[i] Only California has been more heavily impacted than Florida.

[ii] A "bad loan" is characterized by high interest rates, ballooning payments, onerous penalties/fees, etc.

[iii] Preserving the family's environment, inconvenience of moving, sentimental attachment, pride, fear of change, etc., may prompt distressed homeowners to fight for the home even when letting it go might seem the better business decision.

[iv] Also, properties that are not the primary residence are afforded less or no leeway with respect to modification and refinancing criteria, so even where the owner wants to keep the property, it may not be possible.

[v] The term "lender," as used herein, shall encompass both the actual holder of the note as well as any servicing company representing the same. Moreover, the scope of this article does not include foreclosure actions initiated by non-lender parties such as homeowner associations.

[vi] Failure to provide such notice or to attach a copy of the same to the foreclosure complaint may be an affirmative defense since there can be no acceleration without proper notice and a foreclosure suit relies on the plaintiff's entitlement to accelerate the loan. *See* LRB Holding Corp. v. Bank of America, N.A., 944 So. 2d 1113 (Fla. 3d D.C.A. 2006); Cause of Action to Accelerate Maturity of Debt, 16 Causes of Action 391 (2008); Restatement (Third) of Property (Mortgages) § 8.1 (1997).

[vii] Real Estate Settlement Procedures Act, 12 USCA § 2506 et. seq.

[viii] Truth-in-Lending Act, 15 U.S.C.A. § 1601 et. seq.

[ix] Fla. Stat. § 494.0078 et seq.

[x] Affirmative defenses based on RESPA or TILA involve a federal question, thus permitting removal to federal court.

[xi] Defense lawyers must be ever mindful of Rule 4-3.1 (Meritorious Claims and Contentions) as well as Rule 4-3.2 (Expediting Litigation), Rules Regulating the Florida Bar.

[xii] *See* Hinton v. Brooks, 820 So.2d 325 (Fla. 5th D.C.A. 2001); 59A C.J.S. Mortgages § 700; 59 C.J.S. Mortgages § 545

[xiii] With affidavits where appropriate.

[xiv] Many courts will routinely set the sale date out as many as 90 days where the property is the primary residence.

[xv] *See* Rule 4-1.3 (Diligence), Rules Regulating the Florida Bar.

[xvi] *See* makinghomeaffordable.gov.

[xvii] *See* specifically Fla. Stat. § 501.1377(3).

[xviii] More precisely, the term used is "foreclosure-rescue consultants," which encompasses loan modification companies.

[xix] Blankenship, Gary, *Glitch Won't Affect Lawyers Handling Foreclosures*, The Florida Bar News, August 1, 2008.

[xx] Blankenship, Gary, *Lawyers See an Increase in Foreclosure Rescue Scams*, The Florida Bar News, August 1, 2008. Killian, Mark D., *Panel Examines the Foreclosure Industry for UPL*, The Florida Bar News, February 1, 2004. Blankenship, Gary, *UPL Committee Examines Foreclosure Companies*, The Florida Bar News, December 15, 2003.

[xxi] Tarbert, Elizabeth, *Ethics Alert: Lawyers Should Be Very Wary of Loan Modifiers*, The Florida Bar News, March 15, 2009. Blankenship, Gary, *Take Care When Working With Foreclosure Rescue Services*, The Florida Bar News, March 15, 2008.

[xxii] *See Administrative Orders Dealing with Foreclosure*, The Florida Bar News, April 30, 2009.

[xxiii] *E.g.* mediation involving a bank representative with authority to modify the loan, disclosure of the homeowner's financial information, and consideration by the lender of the viability of modification. *Id.*

[xxiv] Many lenders are reluctant to accept a deed-in-lieu-of-foreclosure and require that the client first attempt a short sale before even entertaining those discussions.

[xxv] *See* Fla. Stat. § 201.02 and Mortgage Forgiveness Debt Relief Act of 2007, H.R. 3648 – Public Law 110-142

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