Hope Meets Reality

Loan Modification Under HAMP

By Michael Steinlage

This government-imposed right to loan modification fails to strike a balance between lenders' rights to insist on adherence to the terms of loan agreements with borrower's and the public's interests in avoiding the destructive effect of rampant foreclosures.

The economic decline and resulting mortgage crisis of the past several years has placed unprecedented strain on the traditional relationships between lenders and borrowers. Government programs designed to mitigate the effects of the crisis and encourage lenders to consider different approaches to loan defaults have in some instances only complicated the problem by altering homeowners' expectations of their rights and obligations under the loan arrangements that they committed to in better times. The federal government's Home Affordable Modification Program (HAMP) perfectly demonstrates these conflicts.

HAMP's Origins

On October 3, 2008, in the early days of the financial crisis, Congress passed the Emergency Economic Stabilization Act (EESA). 12 U.S.C. §5201 (2008). The EESA allocated $700 billion to restore liquidity to the financial system and support and "preserve homeownership." *Id.* The EESA established the Troubled Asset Relief Program (TARP), which made money available to help achieve these goals. 12 U.S.C. §§5211, 5225 (2008).

HAMP was created on February 18, 2009, under the discretionary authority granted to the secretary of the treasury to "facilitate loan modifications to prevent avoidable foreclosures," and it was implemented through a series of supplemental directives. *See* 12 U.S.C. §5219(a)(1); *Williams v. Geithner*, Civil No. 09-1959 ADM/JJG, 2009 WL 3757380, at *2 (D. Minn. Nov. 9, 2009); U.S. Treasury, Making Home Affordable Program Handbook for Servicers of Non-GSE Mortgages, version 3.3, at 1 (Sept. 1, 2011). HAMP aimed to assist millions of homeowners financially who defaulted on their mortgages or faced imminent risk of default by reducing their monthly payments to affordable and sustainable levels through interest rate reductions, term extensions, principal forbearance, and principal forgiveness. *Geithner*, at *4; U.S. Treasury Dep't, Handbook, *supra*, at 1. In instituting HAMP the federal government sought to provide lenders with incentives to modify an eligible loan permanently when a borrower's income would support the target payment and when—from an investor's perspective—modification would have more advantage than foreclosure. Supp. Treas. Dir. 09-01.

HAMP's Applicability

Contrary to common belief, HAMP does not apply to all loans and lenders. If Fan-

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nie Mae, Freddie Mac, or another government sponsored entity (GSE) owns or guarantees a loan, then HAMP pertains. When a GSE neither owns nor guarantees a loan, servicers may participate voluntarily. Servicers that agree to participate in HAMP do so through a servicer participation agreement. A servicer that commits to the program in this manner agrees

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to reconsider all loans that may be eligible for a modification.

For those loans and lenders subject to HAMP, eligibility requirements limit its applicability. The minimum requirements to determine bottom-line eligibility to participate in the program are (1) the property must be the borrower's primary residence; (2) the principal balance of the loan must be less than $729,750; (3) the borrower's loan must be a first lien originated on or before January 1, 2009; (4) the borrower's total mortgage payment must exceed 31 percent of his or her gross monthly income' and (5) the loan must not have been previously modified under HAMP.

If a borrower meets these threshold requirements, the lender or servicer then must determine whether the borrower meets additional eligibility standards. The threshold criteria for the HAMP program are just that: servicers may, at their discretion, refuse to grant permanent modifications for a number of reasons even to borrowers who meet the threshold requirements. *See* Supp. Treas. Dir. 09-01 (detailing reasons for a servicer's decision to reject a borrower under HAMP). The reasons may include the borrower failed to submit required trial plan payments and failed to provide necessary documentation. Servicers may also refuse to modify loans based on economic calculations: "[S]ervicers must apply a net present value (NPV) calculation to each eligible modification request. Based on the NPV calculation, servicers must modify loans that would result in a greater return with modification than without modification. Servicers need not modify loans for which a greater return would result without modification." *McInroy v. BAC Home Loan Servicing*, 2011 WL 1770947, at *2 (D. Minn. 2011) (citing Supp. Treas. Dir. 09-01, at 4) (citations omitted).

The U.S. Treasury Department has reiterated these reasons as a basis for denying eligibility for a loan modification in subsequent HAMP directives. *See* Supp. Treas. Dir. 10-02.

Challenges to Implementing HAMP

Despite the best intentions of regulators and companies that participated in the program, HAMP has not had the broad and consistent impact that many hoped it would. Through October of 2011, HAMP has resulted in 883,076 homeowners receiving permanent loan modifications that made their loans more affordable and improved their ability to avoid foreclosures. USA Today, *What Went Wrong with Foreclosure Aid Programs*, Dec. 12, 2011, *available at* http://www.usatoday.com/money/economy/housing/story/2011-12-11/foreclosure-aid-program-what-went-wrong/51815400/1. However, many more homeowners continue to succumb to foreclosures.

These mixed results are not surprising considering the crucible of economic distress in which HAMP was created and forced to operate. HAMP was announced just weeks after President Obama took office at a time when home prices had fallen for 30 months in a row. *Id.* Given how quickly the Obama administration launched HAMP, members of the administration knew that "[it] wouldn't be perfect." *Id.*

A recent Government Accountability Office (GAO) survey of housing counselors helping borrowers seeking HAMP modifications chronicle these imperfections: "Almost 60 percent complained that servicers lost documents, 54 percent said trial modifications took too long, and 42 percent said borrowers felt that they were wrongly denied modifications, according to the GAO report." *Id.*

While many blame these problems on the servicers that participate in the program, such arguments fail to account fully for the problems and challenges inherent in HAMP. The U.S. Treasury Department knew when it launched HAMP in early 2009 that servicers were not fully equipped to handle the flood of loan modification requests. *Id.* Servicers have observed that the program's changing guidelines made it difficult to implement. Servicers noted that in one three-month period the U.S. Treasury Department made 100 changes to HAMP, which required servicers to adjust their own procedures, which, in the words of one servicer, made it "'impossible' for servicers to keep up." *Id.* Documentation requirements under HAMP were also considered onerous by some and often contributed to delays. At different points, the U.S. Treasury Department issued program directives that prevented servicers from canceling active trial period plan modifications, creating the appearance of further delays for some borrowers. *See, e.g.*, Supp. Treas. Dir. 09-10.

HAMP-generated Lawsuits

With all the problems inherent in HAMP and the expectations that it created in borrowers it was only a matter of time before borrowers and consumer advocates began to test the litigation waters. One of the first tests came in a class action in 2009 against the U.S. Treasury Department and GSEs charged with implementing HAMP and several prominent loan servicers. *See Williams v. Geithner*, Civil No. 09-1959 ADM/JJG, 2009 WL 3757380 (D. Minn. Nov. 9, 2009).

The plaintiffs in *Geithner* had been denied loan modifications under HAMP and claimed that such actions deprived them of their constitutional right to procedural due process. *Id.* at *4. The plaintiffs argued that the history and requirements of HAMP demonstrated that Congress intended to provide particular benefits to homeowners that constituted protected property interests. The benefits claimed by plaintiffs included (1) the suspension of foreclosure pending a determination on the homeowner's loan modification application, and (2) the right to receive a loan modification. The plaintiffs claims that the defendants were required to honor certain alleged constitutional rights associated

with those protected interests in providing those benefits to the plaintiffs, including written notification of adverse decisions and opportunities to appeal them. *Id.* The plaintiffs sought an injunction of all foreclosures conducted by the defendants in Minnesota until these constitutional infirmities were resolved. *Id.*

In denying the plaintiffs' request for the preliminary injunction, the court in *Geithner* focused on the likelihood of success on the merits and concluded that "the regulations at issue here did not intend to create a property interest in loan modifications for mortgages in default." *Id.* at *6. The court reasoned that loan modifications were not a "right" or an "entitlement," and HAMP permitted servicers to use discretion in administering the program. *See id.* at *6. The federal district court therefore concluded that the "Plaintiffs do not have a legitimate claim of entitlement to a loan modification. Thus, the HAMP does not provide Plaintiffs with a 'protected property interest,' the denial of which must comport with due process protections." *Id.* at *7. Accordingly, the court denied the plaintiffs' motion for a preliminary injunction. *Id.*

Despite the clear lines drawn in *Geithner*, homeowners continue to use HAMP as a basis for opposing foreclosure. Some borrowers argue the failure to consider them for loan modification or representations made regarding the status of their modification preclude lenders from pursuing foreclosure. Others premise their claims on errors and delays in the processing of HAMP applications and lost documentation. The most aggressive borrowers assert that they have actual rights to loan modifications. All these iterations reflect several fundamental misunderstandings regarding HAMP and the limited rights that it confers. The remainder of this article will address the most prominent arguments for dismissal of HAMP-related claims.

HAMP Does Not Confer a Private Right of Action to Enforce Program Procedures

Despite the preponderance of decisions on this issue, many borrowers fail to recognize that HAMP does not provide a private right of action if a servicer fails to adhere to HAMP procedures. As the court in *Marks v. Bank of America, N.A.*, observed,

> Nowhere in the HAMP Guidelines, nor in the EESA, does it expressly provide for a private right of action [to enforce procedures]. Rather, Congressional intent expressly indicates that compliance authority was delegated solely to Freddie Mac. By delegating compliance authority to one entity, Freddie Mac, Congress intended that a private cause of action was not permitted.

2010 WL 2572988 (D. Ariz. June 22, 2010), at *6 (citation omitted) *See also* Supp. Treas. Dir. 09-01, at 25.

The rationale for this approach is sound because a servicer would not agree to participate in HAMP if doing so exposed it to private lawsuits and damages based on HAMP's requirements. *See Marks*, 2010 WL 2572988, at *4.

Courts also consistently have rejected claims for breach of contract premised on the servicer participation agreement that governs a servicer's participation in HAMP. *See*, *e.g.*, *Nafso v. Wells Fargo Bank, NA*, No. 11-10478, 2011 WL 1575372, at *4–5 (E.D. Mich. Apr. 26, 2011); *Rivera v. Bank of Am. Home Loans*, No. 09-cv-2450, 2011 WL 1533474, at *3–7 (E.D.N.Y. Apr. 21, 2011); *Orcilla v. Bank of Am., N.A.*, No. C10-03931, 2010 WL 5211507, at *3 (N.D. Cal. Dec. 16, 2010); *Speleos v. BAC Home Loans Servicing, L.P.*, No. 10-11503, 2010 WL 5174510, at *3–5 (D. Mass. Dec. 14, 2010); *Phu Van Nguyen v. BAC Home Loan Servs.*, No. C-10-01712, 2010 WL 3894986, at *4 (N.D. Cal. Oct. 1, 2010); *Marks v. Bank of Am., N.A.*, No. 03:10-cv-08039, 2010 WL 2572988, at *5 (D. Ariz. Jun. 22, 2010); *Escobedo v. Countrywide Home Loans, Inc.*, No. 09-cv-1557, 2009 WL 4981618, at *3 (S.D. Cal. Dec. 15, 2009); *Hoffman v. Bank of America*, Civ. No. 10-2171 SI, 2010 WL 263573 (N.D. Cal. June 30, 2010). These courts recognize that homeowners are at most incidental beneficiaries of these contracts and as such they may not sue as third-party beneficiaries to those contracts.

The *Hoffman* case illustrates how courts are likely to view a claim of alleged neglect in the processing of a HAMP loan modification. In *Hoffman*, the plaintiff claimed that the lender "delayed him for more than a year by, among other things, going long periods of time without communicating, [and] repeatedly telling plaintiff his documentation was lost with requests to resend it." *Hoffman*, 2010 WL 263573, at *1. The borrower in *Hoffman* sued for breach of contract claiming that he was a third-party beneficiary of the obligations assumed under HAMP. *Id.* ("Plaintiff complains that defendants breached their contractual duties by failing to provide the opportunity to accept loan modifications to eligible borrowers."). In response to these claims, the *Hoffman* court held that "[l]enders are not required to make loan modifications for borrowers [even if they] qualify under HAMP nor does the servicer's agreement [confer] an enforceable right on the borrower." *Id.* at *5. The court in *Hoffman* held that the plaintiff did not have a private right of action to enforce HAMP and dismissed the plaintiff's breach of contract claim. *Id.*

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U.S. Treasury Directives and HAMP Standardized Forms Do Not Establish a Reasonable Expectation of Receiving a Modification

Borrowers also often fail to show their reliance on alleged promises of a loan modification is reasonable based on the language of the HAMP documents and the federal guidance implementing the program, which make clear that HAMP does not obligate a servicer to modify a loan. *See Williams v. Geithner*, Civil No. 09-1959 ADM/JJG, 2009 WL 3757380 (D. Minn. Nov. 9, 2009); *Cox v. Mortgage Electronic Registration Systems, Inc.*, Civil No. 10-4626 (DSD/SER) (D. Minn. June 20, 2011); *Brisbin v. Aurora Loan Services, LLC*, Civ. No. 10-2130 (RHK/JJK), 2011 WL 1641979 (D. Minn. May 2, 2011); *Lucia v. Wells Fargo Bank, N.A.*, Civ. Nos. 10-04749 JSW, 10-056073 JSW, 2011 WL 3134422 (N.D. Cal. Apr. 11, 2011). Even courts that recognize that

HAMP does not preclude state law claims grounded on modification-related conduct generally recognize that modification-related claims premised on the right to a loan modification under HAMP fail to state a claim as a matter of law. *See, e.g., Scott v. Wells Fargo Bank, N.A.*, Civil No. 10-3368 (MJD/SER), 2011 WL 3837077 (D. Minn. Aug. 29, 2011); *Olivares v. PNC Bank, N.A.*, Civil No. 11-1626 ADM/JJK, 2011 WL 4860167 (D. Minn. Oct. 13, 2011). The argument is even stronger in states that require that credit agreements be in writing. *See, e.g., Olivares v. PNC Bank*, No. 11-1626, 2011 WL 4860167, at *5 (D. Minn. Oct. 13, 2011) (recognizing heightened writing requirements on credit agreements, including home loan modifications, under Minn. Stat. §513.33); *Shetney v. Shetney*, 49 Wis. 2d 26, 38–39, 181 N.W.2d 516 (1970) ("It is not enough that the parties think that they have made a contract; they must have expressed their intentions in a manner that is capable of understanding. It is not even enough that they have actually agreed, if their expressions… are not such that the court can determine what the terms of that agreement are." (quoting 1 CORBIN Contracts §95, at 394)).

A Trial Period Plan Does Not Guarantee a Loan Modification

Borrowers that recognize the problems associated with claims based solely on oral representations often point to the trial period plan document as evidence of a right to a loan modification. However, the language of the trial period plan mandated by HAMP expressly rejects this argument. The standard trial period plan states:

> I understand that the Plan is not a modification of the Loan Documents and that the Loan Documents will not be modified unless and until (i) *I meet all of the conditions required for modification*, (ii) *I receive a fully executed copy of a Modification Agreement*, and (iii) the Modification Effective Date has passed. I further understand and agree that the Lender will not be obligated or bound to make any modification of the Loan Documents if I fail to meet any one of the requirements under this Plan.

In *Lucia v. Wells Fargo Bank*, the court held that this language supported dismissing the plaintiffs' breach of contract claim:

> Under the language of the TPP Contract, a binding modification would not result unless and until [the lender] determined that plaintiff complied with the requirements. If [the lender] so determined, then it would send plaintiff a modification agreement, including a new monthly payment amount, which both plaintiff and defendant would execute.

Nos. C 10-04749 JSW, C 10-05073 JSW, 2011 WL 3134422, at *6 (N.D. Cal. April 22, 2011) (quoting *Grill v. BAC Home Loans Servicing LP*, Civ. No. 10-CV-03057-FCD/GGH, 2011 WL 127891, at *4 (E.D. Cal. Jan. 13, 2011)).

In *Lucia*, the plaintiff alleged that although he complied with the requirements of the trial payment plan, "he was never offered a permanent mortgage modification." *Id.* After reviewing the decisions of other courts addressing similar claims, the court in *Lucia* granted the lender's motion to dismiss the breach of contract claim based on the plaintiffs' failure to allege "that they met all the conditions set forth in the TPP Contract… including receipt of a 'fully executed copy of a Modification Agreement.'" *Id.* at *7.

Implied Duty of Good Faith and Fair Dealing Arguments Will Fail

Borrowers frequently claim that errors and delays in connection with their attempts to qualify for loan modification constitute a breach of the implied duty of good faith and fair dealing. In most states, "all contracts include an 'implied covenant of good faith and fair dealing' that prevents one party from 'unjustifiably hindering the other party's performance of the contract.'" *See, e.g., McInroy v. BAC Home Loan Servicing, LP*, No. Civ. 10-4342 (DSD/SER), 2011 WL 1770947, at *3 (D. Minn. May 9, 2011) (quoting *Midwest Sports Mktg., Inc. v. Hillerich & Bredsby of Can., Ltd.*, 552 N.W.2d 254, 268 (Minn. Ct. App. 1996)). However, a court may not use the duty of good faith and fair dealing to modify the existing contractual obligations of the parties. *See, e.g., Tele-Port, Inc. v. Ameritech Mobile Communications, Inc.*, 637 N.W.2d 782 (Wis. Ct. App. 2001). In addition, the duty of good faith often does not apply to the parties' conduct in *negotiating* or *forming* contracts. *See, e.g., Hauer v. Union State Bank of Wautoma*, 532 N.W.2d 456 (Wis. Ct. App. 1995) (citing W.S.A. 401.203). Thus, when a mortgage agreement does not provide a right to modify the mortgage, the implied duty of good faith and fair dealing cannot create such a right.

Conclusion

Contract law at its core "permits parties to bargain for obligations to one another rather than having obligations based on social interests imposed by law." *Prent Corp. v. Martek Holdings, Inc.*, 238 Wis. 2d 777, 618 N.W.2d 201 (Wis. Ct. App. 2001). In creating HAMP, Congress and the U.S. Treasury Department sought to strike a balance between lenders' rights to insist on adherence to the terms of loan agreements with borrowers' and the public's interests in avoiding the destructive effect of rampant foreclosures. But a government-imposed right to loan modification would not achieve this balance and premising claims on the argument that the government created a right to modification through HAMP overstate the right that HAMP confers.