

**STEALING THE AMERICAN DREAM: CAN
FORECLOSURE-RESCUE COMPANIES CIRCUMVENT
NEW LAWS DESIGNED TO PROTECT HOMEOWNERS
FROM EQUITY THEFT?**

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I. INTRODUCTION

Major media outlets have recently reported numerous stories about rising foreclosure rates.¹ When people hear about the victims of these stories, they may unconsciously sympathize with them—as in “them” poor folks.² But nationwide, middle-class communities are also experiencing an increase in foreclosures.³ The rising foreclosure rates have been linked to the proliferation of nontraditional mortgages.⁴ These

1. See, e.g., Lingling Wei, *The ‘Helpers’ Want Your House*, WALL ST. J., Nov. 25, 2006, at B4; *Foreclosures Are Up On Some Mortgages*, N.Y. TIMES, Sept. 14, 2006, at C2; Danielle Red, *Foreclosures Pick Up with Midwest Hardest Hit*, WALL ST. J., Apr. 14, 2006, at A8.

2. See, e.g., Posting of Sam Glover to Caveat Emptor, <http://caveatemptorblog.com/> (Dec. 5, 2006, 12:23 CST).

3. See, e.g., *Foreclosures Are Up on Some Mortgages*, supra note 1 (stating that foreclosures involving prime adjustable mortgages increased to a four-year high in the second quarter of 2006 and that this increase indicates that “more homeowners with good credit ratings are having trouble paying bills”); Dona Dezube, *Heroic Homeownership*, MORTGAGE BANKING, June 2006, at 82, 89 (discussing the increasing number of foreclosures and stating that a nonprofit specializing in providing foreclosure-prevention counseling received an increasing amount of calls from “suburban homeowners who are making a decent income but fretting about their” adjustable-rate mortgages). It does not appear that there is any research demonstrating to what extent members of the middle class are undergoing foreclosure proceedings or falling prey to foreclosure fraud.

4. ROBERTO QUERCIA ET AL., THE COST-EFFECTIVENESS OF COMMUNITY-BASED FORECLOSURE PREVENTION 3 (2005), http://www.fhfund.org/_dnlld/reports/MFP_Full-Report.pdf (“For all types, the foreclosure rate as of June 2002 was 1.15 percent, the highest ever. The rates, however, vary significantly by type. For prime conventional mortgages, the rate was 0.27 percent as of June 2002. For subprime mortgages, the rate was 6.4 percent, with rates over 12.5 percent for C, CC, and D rated loans.” (citations

popular mortgage products—adjustable-rate mortgages and interest-only loans—have allowed more consumers to buy homes they could not have afforded under traditional lending standards.⁵ With interest-rate adjustments, homeowners on tight budgets cannot afford the jump in mortgage payments (as much as 20 to 50 percent) and wind up in foreclosure.⁶ Many of these homeowners are sitting on five- and six-figure amounts in home equity as a result of the escalation in real-estate values in the last decade.⁷

Today's successful thieves steal the "money" in consumers' homes—not the cash hidden in mattresses or buried in basements, but the equity that consumers have built up while trying to realize the American dream of home ownership.⁸ The initial message from the "foreclosure rescuer" to the homeowner is typically "Stop foreclosure with just one phone call," or "Do you need instant debt relief and CASH?"⁹ Some foreclosure rescuers lend money to desperate homeowners but structure the lending transaction as a sale with a lease-back agreement.¹⁰ Others use a bait-and-switch scheme in which the homeowner facing foreclosure

omitted)); *see also infra* notes 51-65 and accompanying text. Homeowners with subprime loans are also more likely than homeowners with conventional mortgages to default. Jeremy Peters, *Bankers Report More Mortgages Being Paid Late or Not at All*, N.Y. TIMES, Dec. 14, 2006, at C6.

5. *Regulators Propose Guidance on Nontraditional Home Mortgages*, HDR CURRENT DEVELOPMENTS, Jan. 2, 2006, at 25 ("Nontraditional mortgages include interest-only loans, where borrowers pay no principal during the first few years, and payment-option adjustable-rate mortgages, where borrowers can choose a minimum payment that may be less than the interest due, resulting in negative amortization.").

6. *See, e.g.*, Complaint at 2, *Vaughn v. DeMesa*, No. 1:04CV0027 (W.D. Mich. Jan. 14, 2004) [hereinafter *Vaughn Complaint*]; *infra* notes 26-34 and accompanying text (telling the story of Lynette Vaughn, a homeowner with \$48,000 in home equity, who fell for a foreclosure scam); DeZube, *supra* note 3; Alex Markels, *A Reckoning with Risk*, U.S. NEWS & WORLD REP., Aug. 7, 2006, at 57, 57; Michele Derus, *More Fall Behind on House Payments U.S. Foreclosures Climb 25% from Last Year*, MILWAUKEE J. SENTINEL, July 28, 2006, at D1.

7. *See, e.g.*, Prentiss Cox, *Foreclosure Equity Stripping: Legal Theories and Strategies to Attack a Growing Problem*, 39 CLEARINGHOUSE REV. 607, 609-10 (2006), available at <http://www.povertylaw.org/clearinghouse-review/issues/2006/20060315/cox.pdf>.

8. *See* Editorial, *Target Mortgage Scams*, ROANOKE TIMES, Aug. 7, 2005, at 2; *see also* STEVE TRIPOLI & ELIZABETH RENUART, NAT'L CONSUMER LAW CTR., DREAMS FORECLOSED: THE RAMPANT THEFT OF AMERICANS' HOMES THROUGH EQUITY-STRIPPING FORECLOSURE "RESCUE" SCAMS 7 (2005), <http://www.consumerlaw.org/news/ForeclosureReportFinal.pdf> ("Scam artists fish where the fish are, and one of the great mother lodes of cold, hard cash these days is literally under many Americans' mattresses—the homes they sleep in each night.").

9. TRIPOLI & RENUART, *supra* note 8, at 9.

10. *See id.* at 8-9 (identifying three common rescue frauds).

unknowingly signs documents that actually surrender home ownership.¹¹ Under either arrangement, the home usually sells for less than the fair market value, the homeowner receives little or no money from the sale, and the foreclosure rescuers often forge documents to effectuate the transfer of ownership.¹² The homeowner remains in the home as a renter with an option to repurchase it at a later date.¹³ The terms of the agreement are so onerous, however, that homeowners often default within a few months and are eventually evicted.¹⁴ The end result is that the homeowner loses both the home and all of its built-up equity.¹⁵

Another type of foreclosure fraud leaves the homeowner not only further behind on an existing mortgage, but also obligated on an additional one. Under one nationwide mortgage-elimination scheme,¹⁶ two individuals used an unlicensed, unincorporated entity to convince homeowners to sign and record authentic-looking documents that made their mortgage and equity loans appear satisfied.¹⁷ The homeowners then obtained new loans from mortgage lenders who, relying on public records, believed that the homes were free and clear of any liens.¹⁸ The bulk of the new-loan proceeds went to the con artists and their accomplices.¹⁹ Ultimately, the foreclosure companies cashed out the equity while the original homeowner confronted foreclosure, became liable for two mortgages, and faced potential criminal prosecution for defrauding the lenders.²⁰

To curb these foreclosure-rescue scams, several states have recently enacted statutes regulating foreclosure “consultants” and “purchasers.”²¹

11. *Id.* at 8.

12. *See id.* at 8-9.

13. *See id.* at 9.

14. *See id.*

15. *See id.*

16. Edward Iwata, *Fraud Booms with Mortgage Market*, USA TODAY, Oct. 5, 2005, at B6 (“The FBI is continuing to investigate more than 480 properties in 35 states, with a potential value of \$88 million in loans, that may have been affected by the alleged scheme.”).

17. *See* TRIPOLI & RENUART, *supra* note 8, at 9; Complaint for Injunctive Relief Pursuant to 18 U.S.C. § 1345 at 3, *United States v. Heineman*, No. C 05-2730 (N.D. Cal. July 5, 2005) [hereinafter *Heineman Complaint*]; Declaration of Matthew Ernst in Support of Motion for Temporary Restraining Order and Preliminary Injunction Under 18 U.S.C. § 1345 at 5-6, *United States v. Heineman*, No. C 05-2730 (N.D. Cal. June 30, 2005).

18. *See* *Heineman Complaint*, *supra* note 17, at 3.

19. *See id.*

20. *See, e.g.*, Eileen Mozinski, *Mortgage Scam Reappears*, MILWAUKEE J. SENTINEL, May 27, 2005, at D1.

21. *See, e.g.*, CAL. CIV. CODE § 2945 (West Supp. 2006); COLO. REV. STAT. ANN. § 6-1-1107 (West Supp. 2006); GA. CODE ANN. § 44-14-180 (2002); 765 ILL. COMP. STAT. ANN. 940/50 (West Supp. 2007); MD. CODE ANN., REAL PROP. § 7-307

Part II of this Article describes the growing number of foreclosure-rescue scams,²² the research regarding the vulnerability of consumers to fraud,²³ and the conditions in the real-estate market that have led to a substantial increase in defaults and foreclosure proceedings. Because foreclosure rates continue to rise, unscrupulous individuals have an opportunity to cheat vulnerable homeowners with substantial home equity.

Part III delineates legislative efforts to deter foreclosure fraud and analyzes provisions of recently enacted statutes in several states. Because none of these statutes prohibit foreclosure consultants and purchasers from promising phantom help, these statutes will only be effective in curbing practices that involve clear-cut instances of fraud. Therefore, Part IV recommends that states prohibit foreclosure consultants and purchasers from knowingly promising, at the time of contracting, to perform services that are unlikely to substantially benefit the homeowner. States should also require foreclosure purchasers to immediately pay a homeowner a minimum purchase price of no less than 82 percent of the home's fair market value.²⁴ This price would allow foreclosure purchasers to make a reasonable profit and simultaneously afford homeowners an equity payout.

Part IV introduces a unique solution that would combine a city's 311 call system with an incentive-based disclosure system. Current foreclosure-protection laws constitute a punitive disclosure system that sanctions companies for failing to make certain disclosures. These statutes assume that full disclosure of all onerous contractual terms will effectively deter homeowners from entering into predatory foreclosure-rescue contracts.²⁵ Under this Article's proposed solution, cities would establish a rating system in which organizations exceeding a standard for providing effective foreclosure-intervention services would receive a green rating, organizations meeting the standard would receive a yellow rating, and organizations falling below the standard would receive a red

(LexisNexis Supp. 2006); MINN. STAT. ANN. § 325N.04 (West Supp. 2007); MO. ANN. STAT. § 407.940 (West 2007); N.Y. REAL PROP. LAW § 265-a(7) (McKinney 2007); R.I. GEN. LAWS § 5-79-4 (2006).

22. See TRIPOLI & RENUART, *supra* note 8, at 8-9.

23. See, e.g., COLO. REV. STAT. ANN. § 6-1-1102 (West Supp. 2006) (indicating that many homeowners—particularly the elderly, poor, and financially unsophisticated—are vulnerable to business practices contrived to dispossess homeowners of their home equity).

24. For example, if the home is worth \$100,000 and the indebtedness against it is \$60,000, the foreclosure purchaser would have to contract for a minimum purchase price of \$82,000. At the closing, the purchaser would have to pay the homeowner \$22,000 (\$82,000 less \$60,000). An immediate payout would guarantee that homeowners receive a substantial portion of their equity and increase the likelihood that they will ultimately be able to repurchase their homes from the foreclosure purchasers.

25. See *infra* Part IV.

rating.²⁶ Homeowners could contact the city's 311 call center for direct connection to green- or yellow-rated organizations. Foreclosure rates would then decrease because homeowners could work through their financial issues with legitimate foreclosure-intervention firms, which would have an incentive to meet the rating standard to receive referral business.

II. FORECLOSURE-RESCUE SCAMS

For homeowners struggling to make mortgage payments, foreclosure is their worst nightmare. Some of these homeowners succumb to the wiles of companies offering to rescue them. Lynette Vaughn became such a victim, and her experience demonstrates the deficiencies in recent laws that attempt to protect homeowners from equity theft.²⁷ Vaughn received a letter from Homesavers Group that offered to help prevent foreclosure on her home.²⁸ After receiving her response to the letter, Homesavers sent Ronald DeMesa to Vaughn's home, where he convinced her to execute a document that she thought refinanced the outstanding mortgage debt.²⁹

Instead, she actually sold her home to DeMesa, obligated herself to pay monthly rental payments of \$1,541.46, and received an option to buy back her home for \$165,000 within one year.³⁰ DeMesa borrowed \$148,000 from ABN AMRO Mortgage to finance the purchase of the home.³¹ From this amount, he paid \$116,582.60 (the then-existing mortgage and tax debt) to the lender and tax assessor, \$24,296.15 to Homesavers, and \$2,500 to entities that apparently performed no services.³² Vaughn received nothing from the \$148,000, even though the fair market value of her home was \$165,000, and she only needed roughly \$116,600 to pay the original lender and the tax assessor to

26. This rating system is modeled loosely after the five-star rating system implemented to promote car safety. *See generally* DEREK R.B. DOUGLAS, CTR. FOR AM. PROGRESS, SAFETY SELLS: THE CASE FOR AN INCENTIVE-BASED CREDIT CARD DISCLOSURE SYSTEM I (2006), <http://www.americanprogress.org/issues/2006/11/pdf/creditcards.pdf>.

27. Vaughn Complaint, *supra* note 6, at 2 (stating that Vaughn needed \$67,000 to redeem the home); *see also infra* Part III (analyzing the inadequacies in several foreclosure-protection statutes).

28. Vaughn Complaint, *supra* note 6, at 2.

29. *Id.* at 2-3.

30. *Id.*

31. *Id.* at 2.

32. *Id.* at 2-3.

prevent foreclosure.³³ After filing a lawsuit, Vaughn obtained a default judgment against Homesavers³⁴ and entered into a settlement agreement with DeMesa and ABN AMRO Mortgage for an undisclosed amount.³⁵

Unlike Homesavers, some rescue companies merely desire to profit from the homeowner's financial crisis. For example, they charge an up-front fee to negotiate a deal with the lender by submitting a proposal to reduce the arrearage in mortgage payments, but the "negotiations" are so minimal that the homeowner could have easily done the same.³⁶ These proposals usually raise the homeowner's monthly mortgage payment, and the rescuer often fails to verify whether the homeowner has sufficient income to make the payment.³⁷ Homeowners who fall victim to this fraud are financially worse off for having paid a worthless fee, and still lose their homes.³⁸

Dramatic increases in home values in recent years mean that many homeowners facing foreclosure have substantial home equity and are, therefore, attractive targets for foreclosure fraud.³⁹ Persistent market conditions result in numerous home foreclosures, thereby enticing con artists to seek out these homeowners.⁴⁰ Research supports the conclusion that some homeowners are particularly susceptible to foreclosure fraud.⁴¹

33. *Id.* at 2; Brief in Support of Motion for Default Judgment at 2, Vaughn v. DeMesa, No. 04-0027 (W.D. Mich. Apr. 23, 2004) (stating that Vaughn needed \$116,582.60 to extinguish the liens against her home).

34. *See* Default Judgment at 1, Vaughn v. DeMesa, No. 1:04-CV-27 (W.D. Mich. July 5, 2005) (granting a default judgment for \$115,417.40 and an award of \$3,000 in attorney fees).

35. *See* Stipulation and Order to Dismiss at 1, Vaughn v. DeMesa, No. 04-CV-0027 (W.D. Mich. June 13, 2005) (dismissing all claims and counterclaims due to settlement).

36. *See* TRIPOLI & RENUART, *supra* note 8, at 8.

37. *See, e.g.*, Lisa Kernek, *North Carolina Firm Scams Homeowners Behind in Payments*, SAN DIEGO UNION-TRIB., Feb. 5, 2006, at I11.

38. *See* TRIPOLI & RENUART, *supra* note 8, at 8.

39. *See, e.g.*, Cox, *supra* note 7, at 607-08; *infra* notes 41-44 and accompanying text.

40. *See, e.g.*, Cox, *supra* note 7, at 607 ("Skyrocketing housing prices and high foreclosure levels, accompanied by growth in the subprime lending market, have exacerbated the foreclosure equity-stripping problem.").

41. *See* CONSUMER FRAUD RESEARCH GROUP, NASD INVESTOR EDUC. FOUND., INVESTOR FRAUD STUDY FINAL REPORT 27 (2006), http://www.nasdfoundation.org/WISE_Investor_Fraud_Study_Final_Report.pdf. For full discussion of consumer vulnerability to fraud, see *infra* Part II.B.

A. *Current Market Conditions Facilitate the Exploitation of Vulnerable Homeowners*

Rapid appreciation in home values is a factor in the increase in foreclosure fraud.⁴² According to the U.S. Office of Federal Housing Enterprise Oversight, average home values appreciated more than 100 percent in ten cities,⁴³ and nationwide home values appreciated 57.28 percent from 2001 to 2006.⁴⁴ Default and foreclosure rates have also escalated significantly in various parts of the country.⁴⁵

Analysts expect foreclosure rates to increase even more dramatically in the next few years due to interest-rate adjustments.⁴⁶ Popular “exotic” mortgage products—adjustable-rate mortgages, interest-only loans, no-cost loans, fifty-year mortgages, and loans for more than 100 percent of a home’s value—have allowed consumers to buy more expensive homes than they could have afforded under traditional lending standards.⁴⁷ Within the next two years, adjustable-rate mortgages (ARMs) totaling more than \$1 trillion are due to reset at higher interest rates.⁴⁸ In other words, homeowners with ARMs can expect a 20 to 50 percent jump in their monthly mortgage payments.⁴⁹ These increased payments, coupled

42. See, e.g., TRIPOLI & RENUART, *supra* note 8, at 7; Cox, *supra* note 7, at 607.

43. See Press Release, U.S. Office of Fed. Hous. Enter. Oversight, House Price Increases Continue 18-19 (June 1, 2006) <http://www.ofheo.gov/media/pdf/1q06hpi.pdf> (identifying the twenty metropolitan areas with the highest rates of home appreciation).

44. *Id.* at 8. This appreciation allows cash-strapped homeowners to borrow against the home’s equity to cover expenses. Michael Fratantoni, *Where Are House Prices Headed?*, MORTGAGE BANKING, Jan. 1, 2006, at 32 (discussing the recent rapid growth in house prices and arguing that they reflects the weaknesses and strengths of the local economies).

45. See, e.g., Press Release, Realtytrac, National Foreclosures Decrease 16 Percent in Second Quarter According to Realtytrac U.S. Foreclosure Market Report 2 (July 26, 2006) (on file with the Wisconsin Law Review) (reporting that, while the national foreclosure rate decreased for the second quarter of 2006, the foreclosure rate for the one-year period ending June 2006 increased 25 percent).

46. See, e.g., Ted Cornwell, *Foreclosures Rise, and Trend May Persist*, MORTGAGE SERVICING NEWS, May 1, 2007, at 1, available at 2007 WLNR 8203185 (“The study analyzed 8.37 million ARMs valued at \$2.2 trillion, predicting that 1.1 million of them will go into foreclosure over a six- to seven-year period.”).

47. See JACK GUTTENTAG, THE MORTGAGE ENCYCLOPEDIA: AN AUTHORITATIVE GUIDE TO MORTGAGE PROGRAMS, PRACTICES, PRICES AND PITFALLS 112-32 (2004) (explaining various types of mortgage-loan products).

48. See Markels, *supra* note 6, at 57; Ted Cornwell, *Servicers Facing Boom in ARM Rate Adjustments*, MORTGAGE SERVICING NEWS, Aug. 1, 2006, at 2, 2 (“[T]he interest rate on one-year ARMs has increased by about 75 [percent] over the last two years, and rates show no sign of dropping anytime soon.”).

49. Derus, *supra* note 6. For example, assume that the interest rate is 4 percent on a three-year, \$200,000 ARM. See Anne Thompson, *Have an Adjustable Rate Mortgage? Look Out!*, MSNBC.COM, Aug. 2, 2006,

with rising gas prices and home-energy costs, have led some industry analysts to predict that the foreclosure rate will steadily increase in 2007.⁵⁰ This prediction is strengthened by the fact that ARMs are prevalent among subprime borrowers, consumers already at a greater risk of defaulting and going into foreclosure than consumers with conventional prime loans.⁵¹

A Mortgage Bankers Association survey linked the rise in subprime and predatory mortgage loans (a subset of subprime loans)⁵² to recent increases in default and foreclosure rates.⁵³ Because lenders issue subprime loans to higher-credit-risk borrowers,⁵⁴ these loans have higher interest rates and fees.⁵⁵ Although a uniform definition of a “predatory loan” does not exist, it is generally a loan characterized by any combination of the following lender practices: (1) marketing aggressively to certain groups—such as racial minorities, women, and

<http://www.msnbc.msn.com/id/14156321>. If the rate increases to 7.6 percent, the monthly payment would jump from \$955 to \$1,375, amounting to a 44 percent increase. *Id.*

50. See Cornwell, *supra* note 46, at 1; Thompson, *supra* note 49. *But see* Markels, *supra* note 6, at 57 (“Some worry that mortgage defaults could flood the market with inventory just as demand is cooling. Lenders have little incentive to force that situation, especially now—when the properties they repossess could end up languishing on the market.”).

51. See Markels, *supra* note 6, at 57.

52. JAMES H. CARR & LOPA KOLLURI, FANNIE MAE FOUND., PREDATORY LENDING: AN OVERVIEW 5 (2001), http://www.knowledgeplex.org/kp/text_document_summary/article/refiles/hot_topics/Carr-Kolluri.pdf.

53. See Peters, *supra* note 4.

54. Alvin Arnold, *Financing: Home Mortgage Trends*, MORTGAGE & REAL ESTATE EXECUTIVES REP., Sept. 15, 2006, at 1. Some lenders incorrectly treat some borrowers as posing a higher credit risk. See Deborah Goldstein, *Protecting Consumers from Predatory Lenders: Defining the Problem and Moving Toward Workable Solutions*, 35 HARV. C.R.-C.L. L. REV. 225, 226 (2000) (“The problem of predatory lending is clearly widespread. A recent study by the Federal Home Loan Mortgage Corporation . . . indicated that 10 percent to 35 percent of subprime loans, which ordinarily have higher interest rates than conventional mortgage loans, could actually have been served in the prime market at lower cost.”); OFFICE OF POLICY & RESEARCH, U.S. DEP’T OF HOUS. & URBAN DEV., UNEQUAL BURDEN IN NEW YORK: INCOME AND RACIAL DISPARITIES IN SUBPRIME LENDING fig.5 (2000), <http://www.huduser.org/publications/pdf/newyork.pdf> (reporting findings that 52 percent of borrowers in upper-income, black neighborhoods have subprime refinance loans while only 11 percent of borrowers living in upper-income, white neighborhoods have such loans).

55. Arnold, *supra* note 54, at 1; Debra Pogrud Stark, *Unmasking the Predatory Loan in Sheep’s Clothing: A Legislative Proposal*, 21 HARV. BLACKLETTER L.J. 129, 132 (2005). The subprime market serves a legitimate role in the residential-mortgage industry as it is the market of last resort for consumers with “poor credit histories, insufficient documentation of requisite financial resources or other important loan application information, and other loan application shortcomings that would limit a prospective borrower’s ability to secure credit from the prime market.” CARR & KOLLURI, *supra* note 52, at 5.

the elderly;⁵⁶ (2) charging high interest rates;⁵⁷ (3) charging large up-front fees;⁵⁸ (4) lending without regard to the consumer's ability to repay;⁵⁹ (5) imposing oppressive terms like balloon payments and prepayment penalties;⁶⁰ (6) "packing" loans with unnecessary costs like prepaid credit insurance;⁶¹ and (7) convincing homeowners to frequently refinance residential mortgages for the primary purpose of the lender collecting more fees.⁶²

While lenders may argue that subprime loans are legitimate,⁶³ research suggests that the majority of these loans contain predatory terms⁶⁴ and have led to more consumers buying homes they cannot really afford.⁶⁵ Studies have linked the rise in foreclosure rates to the dramatic

56. Dee Pridgen, *Predatory Lending: The Hidden Scourge of the Housing Boom*, WYO. LAW., Oct. 2005, at 18, 20.

57. On average, interest rates on subprime loans are 3 percent higher than rates on conventional loans. ERIC STEIN, COAL. FOR RESPONSIBLE LENDING, QUANTIFYING THE ECONOMIC COST OF PREDATORY LENDING 16 (2001), <http://www.responsiblelending.org/pdfs/Quant10-01.pdf>. The higher rates and fees associated with subprime lending have led some to argue that the subprime market is operating inefficiently. See, e.g., Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255, 1280 (2002); Cathy Lesser Mansfield, *The Road to Subprime "HEL" Was Paved with Good Congressional Intentions: Usury Deregulation and the Subprime Home Equity Market*, 51 S.C. L. REV. 473, 542 (2000) ("[I]t does not appear that pricing is closely tied to actual risk or any other objective factors.").

58. See Lloyd T. Wilson, Jr., *Effecting Responsibility in the Mortgage Broker-Borrower Relationship: A Role for Agency Principles in Predatory Lending Regulation*, 73 U. CIN. L. REV. 1471, 1480 (2005) ("Fees charged for predatory loans are often 10 to 20 percent of the principal amount (and in some cases even higher), while origination fees charged for prime loans typically range from 0 to 2 percent." (footnotes omitted)).

59. *Id.* at 1482. Known as asset-based lending, this practice involves basing lending decisions on the amount of equity in the borrower's home rather than the borrower's ability to repay the loan. *Id.*

60. David J. Weiner, Comment, *Assignee Liability in State Predatory Lending Laws: How Uncapped Punitive Damages Threaten the Secondary Mortgage Market*, 55 EMORY L.J. 535, 548 (2006) ("While only 2 percent of conventional prime loans have prepayment penalties, approximately 8 percent of subprime loans have them.").

61. Pridgen, *supra* note 56, at 20.

62. *Id.*

63. See, e.g., Margot Saunders, *The Increase in Predatory Lending and Appropriate Remedial Actions*, 6 N.C. BANKING INST. 111, 127 (2002).

64. See DAN IMMERGLUCK & GEOFF SMITH, WOODSTOCK INST., RISKY BUSINESS—AN ECONOMETRIC ANALYSIS OF THE RELATIONSHIP BETWEEN SUBPRIME LENDING AND NEIGHBORHOOD FORECLOSURES 3 (2004), <http://woodstockinst.org/document/riskybusiness.pdf>.

65. See Kathleen C. Engel, *Do Cities Have Standing? Redressing the Externalities of Predatory Lending*, 38 CONN. L. REV. 355, 356-58 (2006); Wilson, *supra* note 58, at 1481 ("[R]ather than measuring risk of default, it is more appropriate to say that the high interest rates and fees [associated with subprime loans] create their own

increase in subprime lending.⁶⁶ Therefore, some homeowners who cannot make their mortgage payments will end up in foreclosure, targeted by unscrupulous companies.⁶⁷

risks of default as they make it more difficult for the borrower to make the required monthly payments.” (emphasis omitted)).

66. See Engel, *supra* note 65, at 357-58 & n.11; QUERCIA ET AL., *supra* note 4, at 3 (stating that, in June 2002, the foreclosure rate for conventional mortgages was 0.27 percent and the rate for subprime mortgages was 6.4 percent); see also ROBERT G. QUERCIA ET AL., CTR. FOR CMTY. CAPITALISM, THE IMPACT OF PREDATORY LOAN TERMS ON SUBPRIME FORECLOSURES: THE SPECIAL CASE OF PREPAYMENT PENALTIES AND BALLOON PAYMENTS 27 (2005), <http://www.kenan-flagler.unc.edu/assets/documents/foreclosurepaper.pdf> (“[E]xtended prepayment penalties increase the odds of foreclosure by an additional 20 percent A balloon-payment requirement increases the incremental odds of foreclosure by 50 percent . . .”).

Other studies have found that subprime loans represent a disproportionate share of foreclosure filings. See, e.g., 1 RICHARD D. STOCK ET AL., CTR. FOR BUS. & ECON. RESEARCH, PREDATION IN THE SUB-PRIME LENDING MARKET: MONTGOMERY COUNTY 7 & tbl.2b (2001), <http://www.mvfairhousing.com/cber/pdf/Report.PDF> (reviewing a sample of foreclosed loans made by subprime lenders in one Ohio county between 1994 and 2000 and finding that up to 72 percent of the loans contained predatory characteristics); Dan Immergluck & Geoff Smith, *Measuring the Effects of Subprime Lending on Neighborhood Foreclosures: Evidence from Chicago*, 40 URB. AFF. REV. 362, 380 (2005) (finding that subprime loans were twenty-eight times more likely than prime loans to result in foreclosure); DEBBIE GRUENSTEIN & CHRISTOPHER E. HERBERT, ABT ASSOCS. INC., ANALYZING TRENDS IN SUBPRIME ORIGINATIONS AND FORECLOSURES: A CASE STUDY OF THE ATLANTA METRO AREA, at iii (2000), <http://www.abtassociates.com/reports/ES-20006470781991.pdf> (finding that subprime foreclosures increased by 232 percent in the Atlanta area between 1996 and 1999, even though overall foreclosure rates were on the decline).

67. See Cox, *supra* note 7, at 607-08 (explaining how increased subprime lending has led to more foreclosures and that rescuers can easily acquire sufficient information to target vulnerable homeowners because foreclosure proceedings require publication). Several states have enacted statutes aimed at deterring predatory lending practices, and preliminary results show that these statutes are working. See *States with Strong Predatory Lending Laws Have Fewer Abusive Loans, Retain Subprime Credit, Study Shows*, HDR CURRENT DEVELOPMENTS, Feb. 27, 2006, at 19 (reporting that such statutes have not reduced the availability of subprime credit).

In addition to subprime and predatory lending, commentators have linked fraud in the lending process to increasing default and foreclosure rates. See, e.g., TRIPOLI & RENUART, *supra* note 8, at 8-10. This sort of fraud sometimes comes to light when numerous homebuyers default on loans insured by the U.S. Federal Housing Administration, and the lender submits claims to the U.S. Department of Housing and Urban Development (HUD) to cover the loans. See, e.g., OFFICE OF INSPECTOR GEN., U.S. DEP'T OF HOUS. & URBAN DEV., SEMIANNUAL REPORT TO CONGRESS 10-11 (2006) [hereinafter HUD SEMIANNUAL REPORT], <http://www.hud.gov/offices/oig/sar55.pdf> (investigating one lender with “an unusually high ration of defaults” and finding that 47 percent of that lender’s defaults “involved one seller, who owned 50 percent of the lender”). HUD and taxpayers bear these losses. See *id.*

B. Research Demonstrating Consumer Vulnerability to Fraud

Of the nine states that have enacted foreclosure-protection statutes,⁶⁸ only Colorado and New York have made legislative declarations about the vulnerability of consumers to foreclosure fraud. The Colorado General Assembly stated that “too many home owners in financial distress, especially the poor, elderly, and financially unsophisticated, are vulnerable to a variety of deceptive or unconscionable business practices designed to dispossess them or otherwise strip the equity from their homes.”⁶⁹ Similarly, New York’s legislature acknowledged that “homeowners who are in default on their mortgages or in foreclosure may be vulnerable to fraud, deception, and unfair dealing by home equity purchasers.”⁷⁰ The consumer-vulnerability research provides a justification for the legislative enactment of stringent laws in order to prevent homeowners from being victimized.⁷¹

1. THE GENERAL POPULATION

While the bulk of this research appears to focus on immigrants and the elderly,⁷² some has concentrated on the vulnerability of consumers in general and of those involved in certain types of transactions (such as online consumers’ vulnerability to “phishing” when surfing the Web).⁷³

68. See CAL. CIV. CODE § 2945 (West Supp. 2007); COLO. REV. STAT. ANN. § 6-1-1107 (West Supp. 2006); GA. CODE ANN. § 44-14-180 (2002); 765 ILL. COMP. STAT. ANN. 940/50 (West Supp. 2007); MD. CODE. ANN., REAL PROP. § 7-307 (LexisNexis Supp. 2006); MINN. STAT. ANN. § 325N.04 (West 2007); MO. ANN. STAT. § 407.940 (West 2007); N.Y. REAL PROP. LAW § 265-a(7) (McKinney 2007); R.I. GEN. LAWS § 5-79-4 (2006).

69. See COLO. REV. STAT. ANN. § 6-1-1102 (West Supp. 2006).

70. N.Y. REAL PROP. LAW § 265-a (McKinney Supp. 2007).

71. In deciding to support legislation aimed at curbing foreclosure fraud, some lawmakers relied on homeowner testimonials. See, e.g., Demetrius Patterson, *New State Laws Cracks Down on Fraudulent “Rescue” Mortgage Companies*, CHI. DEFENDER, June 2-4, 2006, at 2 (“During the hearings held by my committee last summer, I heard terrible stories about families forced out of their homes by unscrupulous bailout companies.” (quoting state Senator Jacqueline Y. Collins)).

72. See, e.g., Monroe Friedman, *Confidence Swindles of Older Consumers*, 26 J. CONSUMER AFF. 20 (1992); Julia Marlowe & Jorge H. Atilas, *Consumer Fraud and Latino Immigrant Consumers in the United States*, 29 INT’L J. CONSUMER STUD. 391 (2005).

73. See, e.g., Julie S. Downs et al., *Decision Strategies and Susceptibility to Phishing*, 149 ACM INTERNATIONAL CONFERENCE PROCEEDING SERIES 79, 88 (2006).

“Phishing” is a general term for criminals’ creation and use of e-mails and websites—designed to look like e-mails and websites of well-known legitimate businesses, financial institutions, and government agencies—in order to deceive Internet users into disclosing their bank and financial

Characteristics which increase consumer vulnerability include cognitive deficiency, social isolation, lack of market power, ignorance of common schemes, negative life experiences, and select personality traits.⁷⁴

Cognitive-ability models suggest that consumers' vulnerability to fraud is connected to their information-processing skills.⁷⁵ As a consumer's education increases, the level of consumer vulnerability decreases because formal schooling enhances reading and decision-making skills.⁷⁶ Practical applications associated with cognitive ability include the capacity to effectively seek outside information,⁷⁷ distinguish between "good" and "bad" sources, and assess the credibility of sales-pitch claims.⁷⁸ Also, consumers who are unaware of common schemes are more likely to be deceived by fraudulent claims.⁷⁹

Social isolation is also a significant indicator of vulnerability.⁸⁰ The consumer's level of social interaction corresponds with receptiveness to a seller's advances, perhaps due to a lack of self-confidence.⁸¹ For example, a lonely or isolated target may respond more positively to

account information or other personal data such as usernames and passwords. The "phishers" then take that information and use it for criminal purposes, such as identity theft and fraud.

Main Street Bank & Trust, Consumer Education: Phishing Scams, http://www.mainstreettrust.com/home/?pageLabel=ced.ced_phish (last visited June 10, 2007).

74. See CONSUMER FRAUD RESEARCH GROUP, *supra* note 41, at 7, 26-27 (describing various personality traits).

75. Jinkook Lee & Horacio Soberon-Ferrer, *Consumer Vulnerability to Fraud: Influencing Factors*, 31 J. CONSUMER AFF. 70, 71 (1997).

76. See *id.* at 83. Higher income alone does not preclude vulnerability. *Id.* at 85 ("While income and education independently contribute to social power by providing monetary resources and cognitive capability, respectively, both income and education jointly contribute to determine one's socioeconomic status, which directly influences social power.").

77. See Carolyn Yoon et al., *Cognition, Persuasion and Decision Making in Older Consumers*, 16 MARKETING LETTERS 429, 436 (2005).

78. See KELLY DEDEL JOHNSON, U.S. DEP'T OF JUSTICE, FINANCIAL CRIMES AGAINST THE ELDERLY 1, 12 (2003), <http://www.popcenter.org/problems/PDFs/Elderly%20guide.pdf>.

79. See, e.g., *id.* at 12; Downs et al., *supra* note 73, at 88 ("Familiarity with very particular scams seemed to be the best predictor for spotting similar ones, but this benefit did not seem to extend to unfamiliar scams.").

80. See, e.g., Wendy Reiboldt & Ronald E. Vogel, *A Critical Analysis of Telemarketing Fraud in a Gated Senior Community*, 13 J. ELDER ABUSE & NEGLECT 21, 25; see also Lee & Soberon-Ferrer, *supra* note 75, at 73 ("Activity theory explains consumer vulnerability as a consequence of social isolation. Social isolation makes individuals feel less connected to friends and sources of information or support and therefore more responsive to sellers, who help isolated individuals feel better by paying attention to them." (citation omitted)).

81. See Reiboldt & Vogel, *supra* note 80, at 26.

tactics such as flattery or fraudulent offers of assistance.⁸² Moreover, family members and friends are an important source of normative views on valid or acceptable marketing practices.⁸³ Without external support and supplies of information, a consumer may be unable to recognize suspicious claims and proposals.⁸⁴

A consumer's personality traits and market power are also factors in a consumer's vulnerability to fraud. Included in these personality traits are distrust of professional advice,⁸⁵ high levels of self-reliance,⁸⁶ optimistic or "wishful thinking" mindsets,⁸⁷ and feelings of entitlement.⁸⁸ Market power is "the ability of a consumer to negotiate the best possible deal in the marketplace" and is partly determined by an individual's social power.⁸⁹ Traditionally underprivileged groups often lack social power because they have generally been held to a lower socioeconomic status in society.⁹⁰

Vulnerability to fraud strongly correlates to the quality of the consumer's recent life experiences. A 2006 study by the NASD Investor Education Foundation reported that victims of investment and lottery fraud experienced a greater number of negative life events than nonvictims.⁹¹ These negative life events included decreased income or financial status, death of a spouse or partner, foreclosures on mortgages or loans, and serious illnesses or injuries.⁹² Emotional states triggered by

82. See Lee & Soberon-Ferrer, *supra* note 75, at 72-73.

83. See *id.* at 72 ("Isolated consumers are eager to socialize, even with strangers, but due to a lack of social interaction they may be unaware of normative beliefs related to fair treatment in the marketplace.").

84. See Reiboldt & Vogel, *supra* note 80, at 26.

85. See CONSUMER FRAUD RESEARCH GROUP, *supra* note 41, at 27.

86. See *id.* at 7 ("The investment fraud victims were more inclined to agree with the statement 'I rely on my own experience and knowledge to make financial decisions' than the nonvictim population. This characteristic may have the effect of isolating victims or causing them to rely on their own judgment when getting advice from others might be more appropriate.").

87. *Id.* at 7 ("In terms of psychological outlook, investment fraud victims were more optimistic than nonvictims . . .").

88. See *id.* at 26-27 ("Lottery victims are more likely to feel that they have not gotten what they deserved out of life.").

89. See Lee & Soberon-Ferrer, *supra* note 75, at 73.

90. See *id.* at 72-73 ("Underprivileged consumers who have low socioeconomic status are in an inferior position to negotiate and are also more easily coerced by dominant groups. Thus, underprivileged groups are more vulnerable to consumer fraud than dominant groups." (citation omitted)).

91. See *id.* at 21.

92. See *id.* at 25 (discussing victims of lottery fraud). The study found that victims of investment fraud "do in fact experience more negative life events than nonvictims" and "that the presence of such life stress might contribute to an individual's vulnerability to being victimized by fraud." *Id.* at 7.

the negative events may reduce the consumer's ability to control the situation and act rationally.⁹³

2. RECENT IMMIGRANTS AND THE ELDERLY

Research shows that recent immigrants and the elderly possess characteristics that make them even more vulnerable to fraud than the general population.⁹⁴ Immigrant vulnerability characteristics include language difficulties, lower market familiarity, less support from family and friends, less education, poverty, and undocumented alienage.⁹⁵ Elderly consumers are susceptible to fraud because they are more accessible,⁹⁶ have greater available assets,⁹⁷ suffer from social isolation,⁹⁸ and have declining cognitive ability.⁹⁹ Con artists target the elderly more

93. See, e.g., Stacey Menzel Baker et al., *Building Understanding of the Domain of Consumer Vulnerability*, 25 J. MACROMARKETING 128, 130 (2005) ("Grief, divorce, and any number of other individual states (mood, severe stress) have the potential to hinder an individual's ability to control his or her situations or respond in a manner that is positive for the self.").

94. See TRIPOLI & RENUART, *supra* note 8, at 18; Lisa Peñaloza, *Immigrant Consumers: Marketing and Public Policy Implications*, 14 J. PUB. POL'Y & MARKETING 83, 83-84 (1995).

95. Marlowe & Atilas, *supra* note 72, at 397 tbl.2.

96. See Friedman, *supra* note 72, at 23 (listing characteristics of the elderly which account for their greater victimization).

97. See *id.*; Reiboldt & Vogel, *supra* note 80, at 23; Nat'l Ctr. of Victims of Crime, *Telemarketing Fraud Against Seniors*, <http://www.ncvc.org/ncvc/main.aspx?dbName=DocumentViewer&DocumentID=35264> (last visited June 10, 2007).

98. Friedman, *supra* note 72, at 23. Studies suggest that loneliness and social isolation increase with age, depriving elderly consumers of outlets for authenticating and balancing consumer information. See, e.g., Eun-Jin Kim & Loren Geistfeld, *Elder Fraud: An American-Korean Comparison*, 52 CONSUMER INTERESTS ANN. 422, 422 (2006). A friendly sales pitch can satisfy an isolated consumer's need for social interaction, making the consumer more receptive to proposals. See JOHNSON, *supra* note 78, at 13; Reiboldt & Vogel, *supra* note 80, at 27 ("Even though high pressure, fast-talking pitches are commonly used by scammers, many elderly people are less likely to think high pressure tactics are unfair, and, moreover, lack the skills to end a telephone conversation or say no and hang up." (citations omitted)).

99. Friedman, *supra* note 72, at 23. Researchers have found that certain cognitive abilities may decline with age, thereby making the elderly more susceptible to fraud. See *id.* The normal aging process often leads to cognitive impairments because cognitive abilities, "such as memory retrieval and processing speed, deteriorate with age." Lee & Soberon-Ferrer, *supra* note 75, at 71-72. Older consumers tend to process familiar information as "true," regardless of the source. See Yoon et al., *supra* note 77, at 434. Furthermore, senior citizens may lack the motivation or means to evaluate a salesperson's claims by seeking additional information. See *id.* at 436. Finally, elderly consumers may exhibit a tendency to avoid decisionmaking and may be more likely to delegate that role to a self-proclaimed "expert." *Id.* at 435.

than any other consumer group,¹⁰⁰ and these crimes are the most costly of all offenses perpetrated against consumers.¹⁰¹

The foregoing research offers strong support for the enactment of laws protecting homeowners from mortgage-foreclosure fraud. Exploitative companies contact homeowners when the fear and stress of imminent foreclosure make them particularly vulnerable.¹⁰² To increase their chances of enticing homeowners, fraudulent foreclosure companies frequently engage in “affinity marketing” such that “African-Americans market these scams to African-Americans, Christians to Christians, older folks to older folks, Spanish-speaking to Spanish-speaking, military to military, and so on.”¹⁰³ These ploys lead homeowners away from the perceived opposition and cause them to believe that the scam artist is on their side.¹⁰⁴ Foreclosure con artists also emphasize the need for fast action, causing panic and discouraging the homeowner from seeking external information.¹⁰⁵ Accordingly, these fraudulent tactics appeal to a broad range of characteristics that increase consumer vulnerability;

100. See Friedman, *supra* note 72, at 20 (“Consumer fraud is a commonly committed crime against the elderly and one type of consumer fraud, confidence games and swindles, is more frequently directed at older citizens than any other.”); see also GLENN MUSCAT ET AL., AUSTL. INST. CRIMINOLOGY, OLDER PEOPLE AND CONSUMER FRAUD (2002), <http://www.aic.gov.au/publications/tandi/ti220.pdf>.

101. See Friedman, *supra* note 72, at 22; Donna Schuyler & Bryan A. Liang, *Reconceptualizing Elder Abuse: Treating the Disease of Senior Community Exclusion*, 15 ANNALS HEALTH L. 275, 279 (2006) (“The average bank robber nets \$2,000 for each heist, while defrauding one elderly victim brings an average take of \$60,000.” (footnote omitted)). Studies show that elderly women are more likely to be victimized than elderly men. See, e.g., Schuyler & Liang, *supra*, at 280 (“Women who are eighty years of age and older are especially at risk because they are abused two-thirds more often than other elderly victims.”).

102. See TRIPOLI & RENUART, *supra* note 8, at 31 (“My overall view is that these scams work because . . . there is an unscrupulous scammer, [and] a desperate and ignorant homeowner who wants to believe that they will be rescued from the brink by the scammer.” (quoting St. Paul lawyer John Tancabel)).

103. *Id.* at 10. Recognizing that some consumers are particularly vulnerable, scam artists use various tactics to appeal to the victims’ different psychological make-ups. See CONSUMER FRAUD RESEARCH GROUP, *supra* note 41, at 6.

104. See TRIPOLI & RENUART, *supra* note 8, at 10, 43.

105. See *id.* at 43 n.16. One foreclosure purchaser used the following solicitation:

TIME IS YOUR ENEMY! If your house payments are more than a month or two behind, your lender has probably already started foreclosure proceedings. As time passes thousands of dollars in penalties and legal fees can be added to the balance you owe. Every single day extra interest is added! The longer you wait the harder it is for us to help you. You must act quickly.

Id.

therefore, extensive consumer protections are necessary to limit the success of mortgage-foreclosure fraud.¹⁰⁶

III. REGULATING DECEPTIVE AND UNCONSCIONABLE PRACTICES IN THE MORTGAGE-FORECLOSURE PROCESS

In response to the growing number of victimized homeowners, nine states have enacted statutes that seek to control the major players in foreclosure fraud,¹⁰⁷ mostly by regulating foreclosure “consultants” and “purchasers.”¹⁰⁸ While these statutes afford homeowners a few substantive rights, they are largely focused on disclosure. Unfortunately, full disclosure of oppressive contractual terms is insufficient to deter homeowners from entering into contracts with rescue companies.

A. Regulation of Foreclosure Consultants

California, Colorado, Illinois, Maryland, Minnesota, Missouri, and Rhode Island have statutes that address foreclosure-consulting fraud¹⁰⁹:

106. Consumer-vulnerability research has led some to conclude that consumers should be educated to avoid scammers and make informed decisions. *See, e.g.,* Lee & Soberon-Ferrer, *supra* note 75, at 86.

107. As one advocate contends, “This new law provides crucial protections for vulnerable homeowners from foreclosure rescue scams, which have become epidemic.” Univ. Neighborhood Hous. Program, *New York State Enacts Law to End “Foreclosure Rescue” Scams*, <http://www.unhp.org/alerts.htm> (quoting Josh Zinner, Director of South Brooklyn Legal Services’ Foreclosure Prevention Project) (last visited June 10, 2007); *see also* Patterson, *supra* note 71.

108. Only two states regulate surplus-equity purchasers—companies that persuade a homeowner to convey funds in excess of the foreclosing lender’s mortgage debt following the foreclosure sale of the home. *See* CAL. CIV. CODE § 2945.1(a)(9) (West 2006); MD. CODE ANN., REAL PROP. § 7-301(g)-(h) (LexisNexis Supp. 2007).

109. *See* CAL. CIV. CODE § 2945.1(a) (West Supp. 2006); COLO. REV. STAT. ANN. § 6-1-1103(4)(a) (West Supp. 2006); 765 ILL. COMP. STAT. ANN. 940 (West Supp. 2007); MD. CODE ANN., REAL PROP. § 7-301(b) (LexisNexis Supp. 2006); MINN. STAT. ANN. § 325N.01(a) (West Supp. 2007); MO. ANN. STAT. §§ 407.935(2)(a) (West 2001); R.I. GEN. LAWS § 5-79-1(a) (Supp. 2006).

Table 1: Statutes Regulating Foreclosure Consultants

	Written Contract Format	Use Language Similar to Negotiation	Must Notarize Owners Signature	Right of Rescission	Notice: No Payment Before Performance	Notice: Cannot Sign Deed, Lien, or Mortgage	Notice: Cannot Guarantee to Refinance/ Save Home	Notice: Owner's Obligation to Repay	Fee Caps	Civil Remedy: Private Cause of Action	Criminal Liability
California	X	X		3 days to cancel, must provide form	X	X			10% of any loan amount	X	Up to \$10,000 and/or 1 year in prison
Colorado	12-point font		X	Cancel at any time, must provide form		X	X	X	Prime interest rate + 2% (max. 8%)		Misdemeanor: up to \$25,000 and/or up to 1 year in prison
Illinois	12-point font	X	X	5 days to cancel; must provide form	X	X			2 monthly mortgage payments/first recent tax installment	X	Class 2 Felony
Maryland	12-point font	X	X	3 days to cancel if involving a transfer of title; must provide form		X		X	8% of any loan amount	X	Misdemeanor: up to \$10,000 and/or up to 3 years in prison
Minnesota	X	X		3 days to cancel, must provide form	X	X			8% of any loan amount	X	Up to \$10,000 and/or up to 1 year in prison
Missouri	X	X		3 days to cancel, must provide form	X	X			10% of any loan amount	X	Class A Misdemeanor
Rhode Island	X	X		3 days to cancel, must provide form	X	X			8% of any loan amount	X	Up to \$10,000 and/or up to 1 year in prison

Although the statutory language varies,¹¹⁰ states essentially define a foreclosure consultant as a person who claims to offer services that will assist the homeowner in retaining the home.¹¹¹ All seven states grant the homeowner the substantive right of rescission.¹¹² These statutes act as disclosure laws by mandating that a foreclosure consultant do most or all of the following: (1) put consulting contracts in writing and employ a specific format,¹¹³ (2) inform the homeowner of the right to cancel or rescind the contract,¹¹⁴ (3) supply the homeowner with a notice-of-cancellation form,¹¹⁵ (4) disclose the exact nature of a consultant's

110. For a detailed discussion of these statutes, see Part III.A.

111. See CAL. CIV. CODE § 2945.1(a); COLO. REV. STAT. ANN. § 6-1-1103(4)(a); 765 ILL. COMP. STAT. ANN. 940/5 (using the term “distressed property consultant”); MD. CODE ANN., REAL PROP. § 7-301(b) (providing similar inclusions in the definition of consultant, including “[s]ystematically contact[ing] owners of property that court records or newspaper advertisements show are in foreclosure or in danger of foreclosure”); MINN. STAT. ANN. § 325N.01(a); MO. ANN. STAT. §§ 407.935(2)(a); R.I. GEN. LAWS § 5-79-1(a). With the exception of California and Missouri, all of these states enacted their statutes within the last three years in response to an increase in foreclosure fraud.

These statutes typically exempt certain entities—including lawyers, licensed real-estate brokers, and lien holders. See CAL. CIV. CODE § 2945.1(b); COLO. REV. STAT. ANN. § 6-1-1103(4)(b); 765 ILL. COMP. STAT. ANN. 940/5; MD. CODE ANN., REAL PROP. § 7-302(a); MINN. STAT. ANN. § 325N.01(b); MO. ANN. STAT. § 407.935(2)(b); R.I. GEN. LAWS § 5-79-1(b).

112. In Colorado, Illinois, and Maryland, homeowners have the right to cancel the contract at any time before the foreclosure consultant has fully performed. See COLO. REV. STAT. ANN. § 6-1-1105(1); 765 ILL. COMP. STAT. ANN. 940/15(a); MD. CODE ANN., REAL PROP. § 7-305(a)(1). Homeowners in California, Minnesota, Missouri, and Rhode Island, however, only have three business days to rescind the contract. See CAL. CIV. CODE § 2945.2(a); MINN. STAT. ANN. § 325N.02(a); MO. ANN. STAT. § 407.937(1); R.I. GEN. LAWS § 5-79-2(a).

113. See CAL. CIV. CODE § 2945.3; COLO. REV. STAT. ANN. § 6-1-1104; 765 ILL. COMP. STAT. ANN. 940/10; MD. CODE ANN., REAL PROP. § 7-306(a)(2); MINN. STAT. ANN. § 325N.03; MO. ANN. STAT. § 407.938; R.I. GEN. LAWS § 5-79-3. Colorado and Maryland mandate the use of twelve-point font throughout the contract. COLO. REV. STAT. ANN. § 6-1-1104(2); MD. CODE ANN., REAL PROP. § 7-306(a)(2). All of these states except Colorado require the wording of the contract to be in the same language employed by the consultant during negotiations. See CAL. CIV. CODE § 2945.3(c); 765 ILL. COMP. STAT. ANN. 940/10(c); MD. CODE ANN., REAL PROP. § 7-306(a)(2); MINN. STAT. ANN. § 325N.03(c); MO. ANN. STAT. § 407.938(3); R.I. GEN. LAWS § 5-79-3(c).

114. See CAL. CIV. CODE § 2945.3(c); COLO. REV. STAT. ANN. § 6-1-1104(5); 765 ILL. COMP. STAT. ANN. 940/10(c); MD. CODE ANN., REAL PROP. § 7-306(c) (LexisNexis Supp. 2006); MINN. STAT. ANN. § 325N.03(c); MO. ANN. STAT. § 407.938(3) (West 2007); R.I. GEN. LAWS § 5-79-3(c).

115. See CAL. CIV. CODE § 2945.3(e); COLO. REV. STAT. ANN. § 6-1-1104(6); 765 ILL. COMP. STAT. ANN. 940/10(e); MD. CODE ANN., REAL PROP. § 7-306(c)(1); MINN. STAT. ANN. § 325N.03(e); MO. ANN. STAT. § 407.938(5); R.I. GEN. LAWS § 5-79-3(e). The type on the cancellation form must be a certain size. See CAL. CIV. CODE § 2945.3(e); COLO. REV. STAT. ANN. § 6-1-1104(6)(c); 765 ILL. COMP. STAT. ANN. 940/10(e); MD. CODE ANN., REAL PROP. § 7-306(c)(2)(iii); MINN. STAT. ANN. § 325N.03(e); MO. ANN. STAT. § 407.938(5); R.I. GEN. LAWS § 5-79-3(e).

services and fees,¹¹⁶ and (5) disclose to the homeowner the consultant's inability to collect any money prior to completion of performance and inability to ask the homeowner to sign any conveyance documents.¹¹⁷

In addition to mandating various disclosures, all seven states regulate the conduct of foreclosure consultants. Foreclosure consultants cannot (1) collect payment from the homeowner before performance is complete; (2) receive compensation greater than the maximum set by state law; (3) take wage assignments, liens, or any other interest to secure payment; (4) receive undisclosed consideration from third parties in connection with services rendered to the owner; (5) acquire an interest in the property; (6) take any power of attorney from the owner, except to inspect documents; or (7) induce or attempt to induce the homeowner to sign a contract that does not comply with statutory requirements.¹¹⁸ Civil remedies are available to homeowners harmed by a consultant's violations of these statutes,¹¹⁹ and certain statutory violations may result in criminal liability.¹²⁰

116. See CAL. CIV. CODE § 2945.3(a); COLO. REV. STAT. ANN. § 6-1-1104(3); 765 ILL. COMP. STAT. ANN. 940/10(c); MD. CODE ANN., REAL PROP. § 7-306(a)(3); MINN. STAT. ANN. § 325N.03(a); MO. ANN. STAT. § 407.938(1) (West 2007); R.I. GEN. LAWS § 5-79-3(a).

117. See CAL. CIV. CODE § 2945.3(b); 2006 Ill. Legis. Serv. 1568; MINN. STAT. ANN. § 325N.03(b); MO. ANN. STAT. § 407.938(2); R.I. GEN. LAWS § 5-79-3(b).

118. See CAL. CIV. CODE § 2945.4(a)-(g); COLO. REV. STAT. ANN. § 6-1-1107(1); 765 ILL. COMP. STAT. ANN. 940/50(a); MD. CODE ANN., REAL PROP. § 7-307; MINN. STAT. ANN. § 325N.04; MO. ANN. STAT. § 407.940(1); R.I. GEN. LAWS § 5-79-4(a). California's statute also forbids foreclosure consultants from contracting with the homeowner to release surplus funds within sixty-five days of the sale of the home. See CAL. CIV. CODE § 2945.4(h). In California and Missouri, a foreclosure consultant who purchases property in violation of the law may only acquire a voidable interest in the property, but a subsequent bona fide purchaser for value with no notice of the consultant's violation can acquire good title. See CAL. CIV. CODE § 2945.4(e); MO. ANN. STAT. § 407.940(5).

119. With the exception of Colorado, these states have afforded the homeowner a private right of action against consultants violating the foreclosure-protection statute. See CAL. CIV. CODE § 2945.6(a); 765 ILL. COMP. STAT. ANN. 940/55(b); MD. CODE ANN., REAL PROP. § 7-320(a); MINN. STAT. ANN. § 325N.06(a); MO. ANN. STAT. § 407.943(1); R.I. GEN. LAWS § 5-79-6(a). Colorado is unique in that civil liability rests on a court's finding of unconscionability. See COLO. REV. STAT. ANN. § 6-1-1109. In addition, each statute voids any contractual provision which attempts to waive the homeowner's statutory rights. See CAL. CIV. CODE § 2945.5; COLO. REV. STAT. ANN. § 6-1-1106(1)(a); 765 ILL. COMP. STAT. 940/45; MD. CODE ANN., REAL PROP. § 7-318(b); MINN. STAT. ANN. § 325N.05; MO. ANN. STAT. § 407.941; R.I. GEN. LAWS § 5-79-5.

120. In California, a consultant who violates the statute may be punished by a maximum fine of \$10,000, up to one year in prison, or both. See CAL. CIV. CODE § 2945.7. Other states have similar provisions. See COLO. REV. STAT. ANN. § 6-1-1108; 765 ILL. COMP. STAT. ANN. 940/65; MD. CODE ANN., REAL PROP. § 7-321(a); MINN. STAT. ANN. § 325N.07; MO. ANN. STAT. § 407.940(2); R.I. GEN. LAWS § 5-79-7.

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B. Regulation of Foreclosure Purchasers

Besides regulating foreclosure consultants, several states have enacted statutes that regulate foreclosure purchasers. California, Colorado, Georgia, Illinois, Maryland, Minnesota, New York, and Rhode Island have addressed the deceptive and unconscionable practices perpetrated by foreclosure purchasers¹²¹:

121. See CAL. CIV. CODE §§ 1695.6, 1695.13; COLO. REV. STAT. ANN. § 6-1-1117; GA. CODE ANN. § 44-14-180; 765 ILL. COMP. STAT. ANN. 940/50(b); MD. CODE ANN., REAL PROP. § 7-311(b); MINN. STAT. ANN. § 325N.17; N.Y. REAL PROP. LAW § 265-a(7); R.I. GEN. LAWS § 5-80-8. Georgia and New York only regulate foreclosure purchasers. GA. CODE ANN. § 44-14-180; N.Y. REAL PROP. LAW § 265-a(7).

Table 2: Statutes Regulating Foreclosure-Property Purchasers

	Written Contract Format	Use Language Similar to Negotiation	Must Notarize Owners Signature	Right of Rescission	Notice: Warning Owner to Seek Advice	Must Verify Ability to Repay	Minimum Purchase Price	Maximum Repurchase Price	Actions Prohibited During Rescission Period	Civil Remedy: Private Cause of Action	Criminal Liability
California	10-point, boldface type	X		5 days to cancel; must provide form					X	X	Up to \$25,000 and/or up to 1 year
Colorado	12-point font			3 days to cancel; must provide form		60% presumption	Cannot exceed 125% of purchase price		X		Misdemeanor: up to \$25,000 and/or 1 year in prison
Georgia	X	Plain language		10 days to cancel; must provide form							
Illinois	X	X	X	5 days to cancel; must provide form		Lists factors to determine ability	82% of fair market value	Cannot exceed 125% of purchase price	X	X	Class 2 Felony
Maryland	12-point font	X	X	3 days to cancel; must provide form	X	60% presumption	82% of net proceeds from resale		X	X	Misdemeanor: up to \$10,000 and/or up to 3 years in prison
Minnesota	12-point, boldface type	X		5 days to cancel; 2 yrs. if in violation of the act		X	82% of fair market value		X	X	\$50,000 and/or 1 year in prison
New York	Also in Spanish if appropriate			5 days to cancel; must provide form	X	50% presumption	82% of fair market value	No unfair/unreasonable terms	X	X	Felony or misdemeanor, prison/\$25,000
Rhode Island	12-point, boldface type	X		5 days to cancel; must provide form		60% presumption	82% of fair market value		X	X	Up to \$50,000 and/or up to 1 year in prison

These statutes are similar to those covering foreclosure consultants.¹²² For example, both foreclosure-consultant and foreclosure-purchaser statutes grant homeowners a right of rescission, require certain disclosures, and authorize civil¹²³ and criminal¹²⁴ penalties.

States differ on important terms that may provide additional protections to homeowners. For instance, Minnesota, New York, and Rhode Island mandate the completion of a “closing” meeting conducted by an independent closing agent or attorney.¹²⁵ New York allows the homeowner to rescind the agreement within two years of the recording date for violations involving the contractual form, required disclosures, cancellation form, or prohibited practices.¹²⁶

Several states protect homeowners from equity stripping by requiring the purchaser to pay the homeowner a minimum purchase price based on the property’s fair market value. In Illinois, Maryland, Minnesota, New York, and Rhode Island, foreclosure purchasers must

122. For a detailed discussion of these issues, see Part III.B.

123. California, Illinois, Maryland, Minnesota, New York, and Rhode Island provide a private cause of action for the injured homeowner, who can typically recover actual damages, reasonable attorney’s fees, and appropriate equitable relief. *See* CAL. CIV. CODE § 1695.7; 765 ILL. COMP. STAT. ANN. 940/55; MD. CODE ANN., REAL PROP. § 7-320(a) to (b); MINN. STAT. ANN. §§ 8.31(3a), 325N.18(1); N.Y. REAL PROP. LAW § 265-a(9) (McKinney 2007); R.I. GEN. LAWS §§ 5-79-6(a), 6-13.1-5.2(a), (d). In civil cases, homeowners can frequently recover exemplary damages. *See* CAL. CIV. CODE § 1695.7; MD. CODE ANN., REAL PROP. § 7-320(c); MINN. STAT. ANN. § 325N.18(2); N.Y. REAL PROP. LAW § 265-a(9); R.I. GEN. LAWS § 5-79-6(b).

124. In California and Colorado a consultant who violates the statute may receive a penalty of up to one-year imprisonment, a \$25,000 fine, or both. *See* CAL. CIV. CODE § 1695.8; COLO. REV. STAT. ANN. § 6-1-1108. In Maryland, the penalty is up to three years in prison, a \$10,000 fine, or both. MD. CODE ANN., REAL PROP. § 7-321(a). In Minnesota and Rhode Island the penalty is up to one year in prison, a \$50,000 fine, or both. *See* MINN. STAT. ANN. § 325N.18(4); R.I. GEN. LAWS § 5-80-9(d) (2007). In Illinois, the offense of criminal-mortgage rescue fraud is a felony. *See* 765 ILL. COMP. STAT. ANN. 940/65, 5/5-8-1. For various criminal penalties imposed under New York law, see N.Y. REAL PROP. LAW § 265-a(10)(a).

125. MINN. STAT. ANN. § 325N.17(a)(2); N.Y. REAL PROP. LAW § 265-a(11)(b)(ii); R.I. GEN. LAWS § 5-80-8. A few states require compliance with the federal Home Ownership Equity Protection Act when the homeowner obtains a vendee interest in a contract for deed. *See* MD. CODE ANN., REAL PROP. § 7-311(b)(1)(iii); MINN. STAT. ANN. § 325N.17(a)(4); R.I. GEN. LAWS § 5-80-8(a)(4); *see also* Anne Balcer Norton, *Reaching the Glass Usury Ceiling: Why State Ceilings and Federal Preemption Force Low-Income Borrowers into Subprime Mortgage Loans*, 35 U. BALT. L. REV. 215, 228 n.199 (2005) (“It is important to note that Congress enacted the Home Ownership Equity Protection Act in 1994, in response to predatory lending abuses.” (citation omitted)).

126. N.Y. REAL PROP. LAW § 265-a(8)(a). The homeowner must give the foreclosure purchaser and their successors notice of rescission and record the cancellation form with the county clerk. *Id.* § 265-a(8)(b). Upon rescission, the foreclosure purchaser or its successor must reconvey title to the property within twenty days, and the homeowner must return any consideration received from the transaction. *Id.*

pay a homeowner at least 82 percent of the fair market value within a certain time period following the homeowner's eviction from or relinquishment of the home, or the purchaser's resale of the home.¹²⁷

Only three states—Colorado, Illinois, and New York—address the contractual terms related to the repurchase of a homeowner's property.¹²⁸ New York's foreclosure-protection statute contains a rebuttable presumption that any transaction which includes an option to repurchase is actually a mortgage loan, rather than an absolute conveyance.¹²⁹ Because many foreclosure purchasers act as de facto mortgage brokers or lenders (but evade the complex regulations governing those industries),¹³⁰ this presumption accurately categorizes the purchaser's contract and represents a significant step towards curtailing unlawful lending practices. New York also prohibits unfair or commercially unreasonable terms of repurchase¹³¹ and bars unconscionable actions by foreclosure purchasers.¹³²

Unlike New York, Colorado and Illinois actually address the maximum repurchase price a foreclosure purchaser can charge a homeowner. In Colorado, a repurchase price greater than 25 percent of the amount paid by the foreclosure purchaser gives rise to a rebuttable presumption of unconscionability.¹³³ Similarly, Illinois prohibits repurchase or lease terms which are unfair or commercially unreasonable,¹³⁴ and limits the repurchase price to 125 percent of the purchaser's original acquisition cost.¹³⁵

127. See 765 ILL. COMP. STAT. ANN. 940/50(b)(2); MD. CODE ANN., REAL PROP. § 7-311(b)(2)(ii); MINN. STAT. ANN. § 325N.17(b)(2); N.Y. REAL PROP. LAW § 265-a(11)(d)(2); R.I. GEN. LAWS § 5-80-8(b)(2).

128. COLO. REV. STAT. ANN. § 6-1-1108; 765 ILL. COMP. STAT. ANN. 940/50(b)(3); N.Y. REAL PROP. LAW § 265-a(11)(a).

129. N.Y. REAL PROP. LAW § 265-a(11)(a). New York's statute is in line with case law from various jurisdictions holding that, when the buyer leases the property back to the seller with the option to repurchase, the transaction constitutes an equitable mortgage. See 1 GRANT S. NELSON & DALE A. WITHMAN, REAL ESTATE FINANCE LAW § 3.19 (4th ed. 2002).

130. See, e.g., Indictment at 2, *Florida v. Rosenberg*, Case No. 2005-0018-MDB, (11th Jud. Cir. Jan. 24, 2006) [hereinafter *Rosenberg Indictment*] (indicting an attorney and several accomplices with organized fraud and second-degree grand theft and charging one defendant with operating as an unlicensed broker). See generally *Cox*, *supra* note 7, at 611.

131. N.Y. REAL PROP. LAW § 265-a(11)(c).

132. See *id.* § 265-a(7)(d). Foreclosure purchasers must notify all standing mortgagees of the conveyance and comply with the terms of the mortgage-lien documents. *Id.* § 265-a(11)(b)(iv).

133. COLO. REV. STAT. ANN. § 6-1-1115(1)(e) (West Supp. 2006).

134. 765 ILL. COMP. STAT. ANN. 940/50(b)(3).

135. *Id.* § 940/50(b)(2).

Allowing the foreclosure purchaser to charge such a repurchase price is arguably too generous, however, particularly given the likelihood that some homes sold in a cooling housing market may not allow an “honest” foreclosure purchaser to obtain a 25 percent profit in one year.¹³⁶ Nevertheless, statutes mandating a maximum repurchase price may prevent purchasers from taking advantage of homeowners. For example, in *Palmer v. Roberts*—one of the few reported cases involving foreclosure fraud—the purchaser and homeowners executed a contract in which the purchaser acquired the home for \$95,000 and then granted the homeowners the option to repurchase for \$141,000.¹³⁷ This transaction amounted to a repurchase price of more than 148 percent of the original price. Given the potential for such unconscionable prices, states regulating foreclosure-purchase contracts should establish a reasonable maximum repurchase price.

Although statutory regulation of foreclosure purchasers and consultants is admirable, states should further amend their statutes to protect the homeowner’s equity and establish an incentive-based disclosure system that connects homeowners with legitimate foreclosure-intervention specialists.¹³⁸

IV. RECOMMENDATIONS TO STRENGTHEN FORECLOSURE STATUTES

Home ownership is the primary way most Americans build wealth, and it is also associated with several societal benefits, including the

136. See DAVID CALLAHAN, DEMOS, HOME INSECURITY: HOW WIDESPREAD APPRAISAL FRAUD PUTS HOMEOWNERS AT RISK 1-2 (2005), http://www.demos.org/pubs/home_insecurity_v3.pdf; see also James Hagerty & Ruth Simon, *Housing Glut Gives Buyers Upper Hand*, WALL ST. J., Jan. 25, 2007, at D1 (stating that the housing market is cooling and that selling prices are decreasing in some areas); *infra* Part IV.A.4 (discussing appraisal fraud and how it allows perpetrators to reap generous profits).

137. No. Civ.A. 04CV73635, 2005 WL 1631267, at *1 (E.D. Mich. July 6, 2005). The required monthly rental payment was over \$1,200—more than the homeowners’ original mortgage payment. See *id.*

138. Lawmakers could also facilitate the creation of a task force to help educate homeowners. In Colorado, the Attorney General’s office charged its task force with creating a public-outreach program to educate vulnerable consumers and making “recommendations to encourage multi-jurisdictional cooperation among law enforcement and other organizations and individuals who confront foreclosure and mortgage scams.” See, e.g., Press Release, John W. Suthers, Colo. Attorney Gen., Attorney General Suthers Establishes Mortgage and Foreclosure Fraud Task Force (July 21, 2005), http://www.ago.state.co.us/press_detail.cfm?pressID=714. The task force consists of district attorneys, public trustees, county clerks, county recorders, and law enforcement from across the state. *Id.*

development of stable communities.¹³⁹ Therefore, states should do more to help consumers sustain home ownership by amending their statutes to (1) prohibit home-equity stripping by limiting the profit that rescue companies can receive from their foreclosure contracts with homeowners, (2) prevent rescue companies from promising phantom help and enticing consumers into entering detrimental contracts, and (3) establish an incentive-based disclosure system that motivates legitimate foreclosure-intervention specialists to submit to a rating system and directs homeowners to those specialists that have achieved the highest ratings. These recommendations envision harnessing the resources of mortgage lenders, nonprofit organizations, and local governments in providing a comprehensive solution to the foreclosure-fraud problem.

A. *Protect Homeowners' Equity by Limiting Rescuer Compensation*

1. LIMIT A FORECLOSURE CONSULTANT'S FEE

Seven states have attempted to prevent home-equity stripping by regulating the fees that foreclosure consultants charge for their negotiating services and the prices that foreclosure purchasers pay to buy the homeowner's property.¹⁴⁰ Most states require disclosure of the exact nature of a consultant's services and the amount of the consulting fee charged to the homeowner.¹⁴¹ When the foreclosure consultant has provided a loan to the homeowner, the amount of compensation that the consultant can legally charge cannot exceed a certain percentage of that loan amount, most commonly 8 percent.¹⁴² The underlying assumption is

139. MARK WIRANOWSKI, JOINT CTR. FOR HOUS. STUDIES, SUSTAINING HOME OWNERSHIP THROUGH EDUCATION AND COUNSELING (2003), http://www.jchs.harvard.edu/publications/homeownership/w03-7_wiranowski.pdf; Cassandra Jones Havard, *Invisible Markets Netting Visible Results: When Sub-Prime Lending Becomes Predatory*, 26 OKLA. CITY U. L. REV. 1057, 1067 (2001).

140. See CAL. CIV. CODE § 2945.4(b) (West Supp. 2006); COLO. REV. STAT. ANN. § 6-1-1107(1)(b) (West Supp. 2006); 765 ILL. COMP. STAT. ANN. 940/50(a)(2) (West Supp 2007); MD. CODE ANN., REAL PROP. § 7-307(2) (LexisNexis Supp. 2006); MINN. STAT. ANN. § 325N.04(2) (LexisNexis Supp. 2007); MO. ANN. STAT. § 407.940(1)(2) (West 2007); R.I. GEN. LAWS § 5-79-4(a)(2) (2006).

141. See, e.g., CAL. CIV. CODE § 2945.3(a); COLO. REV. STAT. ANN. § 6-1-1104; 765 ILL. COMP. STAT. ANN. 940/10(a); MD. CODE ANN., REAL PROP. § 7-306(a)(3); MINN. STAT. ANN. § 325N.03(a); MO. ANN. STAT., § 407.938(1); R.I. GEN. LAWS § 5-79-3.

142. See MD. CODE ANN., REAL PROP. § 7-307(2) (LexisNexis Supp. 2006); MINN. STAT. ANN. § 325N.04(2) (West 2007); R.I. GEN. LAWS § 5-79-4(a)(2) (2006). California and Missouri, however, set their fee caps at 10 percent. See CAL. CIV. CODE § 2945.4(b); MO. ANN. STAT. § 407.940(1)(2). Colorado's fee cap is the prime interest rate plus 2 percent, with a maximum fee of 8 percent. COLO. REV. STAT. ANN. § 6-1-1107(1)(b).

that the consultant will help the consumer obtain a loan and, therefore, base the maximum fee on a percentage of the loan.

The statutes are silent about the maximum allowable fee a consultant can charge if a loan is not obtained for the homeowner. They should, however, set a maximum fee because consultants may charge for questionable services unrelated to any loan.¹⁴³ Only Illinois has established a maximum fee which applies regardless of whether a consultant has made a loan;¹⁴⁴ the maximum consultant fee is the lesser of the sum of two monthly mortgage payments or the most recent tax installment on the homeowner's property.¹⁴⁵ For example, in Vaughn's case, her tax installment for 2001 was about \$2,500, but Homesavers, as the consultant, received \$24,296.15.¹⁴⁶ Assuming that Vaughn's monthly mortgage payments were \$900, under Illinois's foreclosure-protection statute, Homesavers would have only been entitled to receive \$1,800 (twice the monthly payments).¹⁴⁷ By capping the consulting fee, Illinois prevents foreclosure consultants from devouring a homeowner's equity.

2. ESTABLISH A MINIMUM PURCHASE PRICE AND REQUIRE IMMEDIATE PAYMENT

Five states attempt to prevent foreclosure purchasers from stripping a homeowner's equity by obligating them to pay a homeowner 82 percent of fair market value, minus any amounts paid to satisfy the homeowner's outstanding debts.¹⁴⁸ Statutes mandating a minimum purchase price suffer from a major weakness in that they allow the purchaser to pay after reselling the home to a third party, or upon the homeowner's eviction, voluntary relinquishment, or repurchase of the home.¹⁴⁹ This delay in payment deprives the homeowner of the ability to

143. See, e.g., TRIPOLI & RENUART, *supra* note 8, at 28 (identifying several questionable fees).

144. See 765 ILL. COMP. STAT. ANN. 940/50(a)(2).

145. *Id.*

146. See Vaughn Complaint, *supra* note 6, at 2.

147. This conclusion assumes the mortgage monthly payments were under \$900 because the low outstanding mortgage debt; however, the exact amount was not mentioned. See *id.* at 13.

148. See *supra* note 127 and accompanying text.

149. For example, Maryland conditions the purchaser's obligation to pay the minimum price on the resale of the property to a third party within eighteen months of the agreement's execution. See MD. CODE ANN., REAL PROP. § 7-311(b)(2)(ii) (West Supp. 2006). Presumably, if the resale occurs after the eighteen-month period, the homeowner would receive nothing. Illinois's foreclosure statute, which is far from a model of clarity, provides different times when a purchaser must make the equity payment. See 765 ILL. COMP. STAT. ANN. 940/50(b)(2); see also MD. CODE ANN., REAL PROP. § 7-311(b)(2)(ii) (LexisNexis Supp. 2006); MINN. STAT. ANN. § 325N.17(b)(2) (West Supp. 2007); N.Y.

use the equity payment to make the rental payments required under the lease-repurchase agreement or to save for a down payment in order to obtain financing to buy back the home.

For example, under Vaughn's lease-repurchase agreement, she had to make monthly payments of \$1,541¹⁵⁰ and make a balloon payment of \$165,000 at the end of the first year to repurchase her home.¹⁵¹ Failure to repurchase within one year meant that she would lose the option to repurchase at \$165,000.¹⁵² In states that require the foreclosure purchaser to pay the homeowner a minimum purchase price of 82 percent, Vaughn would have been entitled to receive \$135,300.

Table 3: Analysis of Minimum Purchase Requirement

Home's FMV at the time of contracting:	\$165,000	Actual amount Vaughn received:	\$0
Loan amount obtained by foreclosure purchaser:	\$148,000	Minimum purchase price Vaughn is entitled to receive under new law:	\$135,300 = 82% x \$165,000
Amount purchaser paid to extinguish debts against home:	\$116,600	Actual amount Vaughn should receive after subtracting the amount to extinguish debt:	\$135,300 - \$116,600 = \$18,700
Rental payments required under lease/repurchase agreement:	\$1,542	Number of rental payments that could be covered by equity payment:	\$18,700 ÷ \$1,542 = 12 payments

Vaughn's actual equity payment would be \$18,700 after subtracting what the purchaser had to pay to extinguish the liens against her home. By changing the statute to require that the homeowner receive the \$18,700 at or before the closing of the sale of the home to the foreclosure purchaser, a state could ensure that Vaughn would receive an equity payment as a nest egg so that she could pay her rent. Vaughn would,

REAL PROP. LAW § 265-a(11)(d)(2) (McKinney 2007); R.I. GEN. LAWS § 5-80-8(b)(2) (2006).

150. This amount is rounded down from the actual rental payment of \$1,541.46. See Vaughn Complaint, *supra* note 6, at 3.

151. *Id.*

152. *See id.*

therefore, have enough from the equity payout to make rental payments for a year.

States that mandate a minimum-purchase-price payout also require the foreclosure purchaser to verify that the homeowner can afford to pay the rental payment or the repurchase price at the end of the repurchase-option period.¹⁵³ Nothing in Vaughn's case, however, demonstrated that she would have the ability to pay the repurchase price. But, if a statute requires the purchaser to make an immediate equity payout, the homeowner could use that payout as a down payment to convince a new lender to grant a loan towards repurchase of the home before the end of the repurchase-option period. In other words, if Vaughn had been able to make the \$1,541 rental payments and had immediately received an equity payout of \$18,700, then she could have used the equity payout as a down payment to try to obtain a loan from a new lender, and thereby exercise the option to buy back her home before the one-year option period ended.

3. REQUIRE A MINIMUM TWO-YEAR PERIOD FOR REPURCHASE OPTIONS

Besides requiring purchasers to make an immediate equity payout to a homeowner, states should also extend the period for exercising the option to repurchase to a minimum of two years. The typical purchaser's contract requires a balloon payment at the end of one year in order for the homeowner to exercise the option.¹⁵⁴ Because homeowners covered by the foreclosure-protection statutes have already defaulted and gone into foreclosure, they have bad credit.¹⁵⁵ These homeowners may need up to two years to substantially improve their credit scores.

Under FICO—the predominant scoring system used in America¹⁵⁶—a major delinquency that is between one and two years old

153. See COLO. REV. STAT. ANN. § 6-1-1115(1)(d) (West Supp. 2006); 765 ILL. COMP. STAT. ANN. 940/50(b)(2); MD. CODE ANN., REAL PROP. § 7-311(b)(1)(i); MINN. STAT. ANN. § 325N.17(a)(1); N.Y. REAL PROP. LAW § 265-a(11)(b)(i); R.I. GEN. LAWS § 5-80-8(a)(1). For a full discussion, see *infra* notes 212-18 and accompanying text.

154. See TRIPOLI & RENUART, *supra* note 8, at 26; Cox, *supra* note 7, at 612 (stating that contracts are structured so that only a short period of time passes before a balloon payment is due).

155. A credit score is a number that reflects a person's credit history and is used by lenders to assess a person's credit worthiness. See NAT'L CONSUMER LAW CTR., GUIDE TO SURVIVING DEBT 98 (2002).

156. *Id.* at 99. Generally, individuals with the highest scores are able to obtain mortgages, car loans, and credit cards at more favorable rates. EVAN HENDRICKS, CREDIT SCORE & CREDIT REPORTS 13 (2004). For a technical explanation of the credit scoring, see Karen Gross, *Give Credit Where Credit Is Due—The Use of Credit Scoring*, 58 CONSUMER FIN. L.Q. REP. 267, 267 (2004) (noting that a credit score reflects a mathematical model based on statistical information about consumer behavior).

has “a 60 [percent] negative impact” on an individual’s credit score.¹⁵⁷ FICO places a “great deal of weight on how recently” an individual has experienced the credit problem, and sometimes how recently the problem has occurred is more important than the problem itself.¹⁵⁸ It usually takes up to two years of timely payments for an individual’s credit score to improve sufficiently for that individual to qualify for a loan at an affordable interest rate.¹⁵⁹ By requiring that repurchase-option periods be at least two years, statutes would increase the likelihood that a homeowner can actually exercise the option. Moreover, statutes should require all purchasers to report the timely payments to credit bureaus.¹⁶⁰ Otherwise, homeowners will not benefit from a recent history of timely payments and, therefore, will not be able to convince a new lender to grant them a loan.¹⁶¹

Some may argue that homeowners should simply consult a real-estate agent who could help sell the home on the open market, which may provide the greatest equity payout.¹⁶² For example, had Vaughn been able to sell her home on the open market for its fair market value (\$165,000), she would have been in a better position because she would have received an equity payout of \$48,400 rather than the \$18,700 required under the new statutes. The reality, however, is that homeowners who fall for foreclosure-rescue scams do not want to sell their homes. For most homeowners, a home is not just an investment-portfolio asset; it is the realization of a dream, and it holds great sentimental value.¹⁶³ This explains why so many homeowners in serious financial trouble go to great lengths, even filing bankruptcy, to maintain

157. See HENDRICKS, *supra* note 156, at 25.

158. *Id.* at 24-25.

159. See, e.g., Karen Bankston, *Do the Math*, CREDIT UNION MGMT., Nov. 2001, at 24, 26. Rebuilding one’s credit history after a bankruptcy filing may take about five years of paying bills on time before a person can qualify for the most favorable loans. Eileen Ambrose, *What’s Next After Bankruptcy?*, CHI. TRIB., Apr. 2, 2002, at N5.

160. See Gross, *supra* note 156, at 306 (“Consumers who rent from well-established landlords or who borrow from big payday loan operations may have their information added to their credit reports, but individuals who rent from a single homeowner or borrow from a one-shop lender—even if they make regular payments on time—will not benefit from [FICO’s] ‘improved’ credit score.”).

161. See *id.* For an argument that creditors servicing clients in the subprime market should report their clients’ payment histories to the credit bureaus, see Richard R.W. Brooks, *Credit Past Due*, 106 COLUM. L. REV. 994 (2006).

162. Interests and penalties accruing until the foreclosure sale and the costs of the foreclosure sale itself can substantially reduce or even eliminate a homeowner’s equity. See Debra Pogrud Stark, *Become a Hero to a Family in Need: Predatory Lenders Beware*, 18 PROB. & PROP. 9, 13 (2004).

163. See Julia Patterson Forrester, *Mortgaging the American Dream: A Critical Evaluation of the Federal Government’s Promotion of Home Equity Financing*, 69 TUL. L. REV. 373, 427 n.295 (1994).

possession of their homes.¹⁶⁴ Perhaps the optimal solution is to establish a system that enables homeowners to receive as much information as possible to help them make the best decision given their financial circumstances.¹⁶⁵ If homeowners could take advantage of the services provided by independent, trained foreclosure-intervention specialists,¹⁶⁶ they would be able to decide whether selling is the best option.

4. REQUIRE DISINTERESTED THIRD-PARTY APPRAISALS TO DETERMINE
MINIMUM PURCHASE PRICE

States mandating a minimum purchase price (and a maximum repurchase price) have tacitly assumed the accuracy of appraisals performed by licensed appraisers. Of the eight states regulating foreclosure purchasers, four are silent about appraisals. The other four create a “rebuttable presumption that an appraisal by a person licensed or certified by an agency of the federal government or this state to appraise real estate constitutes the fair market value of the property.”¹⁶⁷ Unfortunately, it appears that these statutes ignore the reality of widespread appraisal fraud.¹⁶⁸

In March 2004, the National Association of Realtors released a statement indicating that pressure by lenders and brokers was “beginning to erode the independent judgment of appraisers,” and was “contributing to the ability of unscrupulous individuals to engage in improper loan practices.”¹⁶⁹ A report from Demos—a nonpartisan, public-policy group—indicated that, based on studies of appraisal fraud and inflation, “the deliberate manipulation of property values is pervasive.”¹⁷⁰ For

164. *See id.*

165. *See* COLO. REV. STAT. § 6-1-1102 (West Supp. 2006) (“There is a compelling need . . . to provide each home owner with information necessary to make an informed and intelligent decision regarding transactions with certain foreclosure consultants and equity purchasers”); N.Y. REAL PROP. LAW § 265-a(1)(d) (McKinney Supp. 2007) (“The intent and purposes of this section are to provide a homeowner with information necessary to make an informed and intelligent decision regarding the sale or transfer of his or her home to an equity purchaser”).

166. *See infra* Part IV.C.1 (recommending the creation of a rating system and a 311 mortgage-default hotline to direct homeowners to legitimate organizations specializing in foreclosure assistance).

167. 765 ILL. COMP. STAT. ANN. 940/50(c) (West 2007); *see also* MINN. STAT. ANN. § 325N.17(b)(2)(i) (West Supp. 2007); N.Y. REAL PROP. LAW § 265-a(11)(d)(ii)(A); R.I. GEN. LAWS § 5-80-8(b)(2)(i) (2006).

168. *See* CALLAHAN, *supra* note 136, at 1-2; *see also infra* notes 174-81 and accompanying text.

169. CALLAHAN, *supra* note 136, at 4.

170. *Id.* Consequently, it is unclear how many first-time homebuyers and homeowners who have refinanced have borrowed more than their homes’ worth.

example, the 2003 National Appraisal Survey, which surveyed 500 appraisers in forty-four states, reported that 55 percent of them felt pressured to inflate property values.¹⁷¹

Appraisers accuse lenders, brokers, and real-estate agents of pressuring them to come back with the “magic” number.¹⁷² Lenders do not have an incentive to ensure accurate appraisals; because their compensation is based on a commission, their primary goal is to close loans.¹⁷³ They can sell most residential loans quickly on the secondary market, and are rarely forced to buy back loans in default with overstated appraisals.¹⁷⁴ Similarly, because broker compensation is also commission based, brokers need not be concerned about the inaccuracy of appraisals.¹⁷⁵ Real-estate agents likewise earn commissions, are not affected by loans in default, and, therefore, often pressure appraisers to inflate property values.¹⁷⁶

As a result of pervasive appraisal fraud, states should require the court in judicial-foreclosure cases or the lender in other foreclosure proceedings to appoint a disinterested, licensed appraiser. The cost of this appraisal could be added to the costs of the lender that initiated the foreclosure proceeding. These recommendations should prevent equity stripping by unscrupulous foreclosure-rescue companies.

171. *Id.*

172. *See id.*

173. *See id.* at 2-3.

174. *See id.* at 3. One report claims that “up to half of all appraisers have reported feeling pressures from lenders or brokers to overstate property values.” *Id.* at 1. Demos cofounder David Callahan has explained the low risk of a forced buy-back as follows:

Now, many mortgages are quickly sold to a large secondary market of debt holders such as quasi-government sponsored entities like Freddie Mac and Fannie Mae. In principle, these secondary holders of mortgage-backed securities can force lenders to buy back loans where property values have been overstated, and many larger lenders have rigorous systems in place to ensure that appraisals are accurate so that this doesn’t happen. In practice, the risk of such forced buybacks can seem low and lenders may worry less than they used to about being stuck with a foreclosed property that is worth less than its appraised value.

Id. at 3.

175. *Id.* at 2-3. Mortgage brokers handle about half of all residential mortgage loans. KATHLEEN E. KEEST & ELIZABETH RENUART, NAT’L CONSUMER LAW CTR., *THE COST OF CREDIT: REGULATION AND LEGAL CHALLENGES* § 11.3.1.5.2, at 510 (2d ed. 2000).

176. *See CALLAHAN, supra* note 136, at 3; *see also* Steve Smith, *Predatory Lending, Mortgage Fraud, and Client Pressures*, *APPRAISAL J.*, Apr. 2002, at 200, 212.

B. Prohibit Foreclosure-Rescue Companies from Promising Phantom Help

1. PREVENT ILLUSORY PROMISES

To be effective, foreclosure-protection statutes should prohibit foreclosure consultants and purchasers from promising phantom help—services they know or have reason to know, at the time of contracting, are not likely to substantially benefit the homeowner. Current statutes may not adequately protect homeowners if a rescue company makes illusory promises that result in very little work being performed on their behalf.

North Carolina-based Homesavers USA is an example of a foreclosure consultant that may provide phantom help to consumers while evading statutory liability.¹⁷⁷ Homesavers collects its fees (which range from \$350 to \$900) up front and guarantees that, if a homeowner follows its instructions, there will not be a foreclosure.¹⁷⁸ To fulfill its contractual obligations, Homesavers prepares and sends the mortgagee a form document entitled “Loss Mitigation Report and Delinquency Solution Proposal,” along with a response form for the mortgagee to indicate whether it approves of the proposal.¹⁷⁹ According to a lawsuit initiated against Homesavers by Illinois Attorney General Lisa Madigan,¹⁸⁰ preparing and sending these two documents comprise the extent of the “negotiations” that Homesavers undertakes.¹⁸¹ Homesavers allegedly makes no effort to actually contact the mortgagee by telephone or in person.¹⁸²

While the contract guarantees homeowners that they will not lose their homes, Homesavers could satisfy this guarantee by simply referring the homeowner to a bankruptcy attorney.¹⁸³ Madigan’s complaint

177. Although Homesavers USA’s name is very similar to Homesavers Group LLC, *see supra* Part II, nothing in the complaints filed against them suggests that these entities are related.

178. *See* Complaint at 4-5, Illinois v. Homesavers, No. 2006 059 (Ill. Cir. Ct. Jan. 30, 2006) [hereinafter Homesavers Complaint].

179. *See id.* at 6.

180. *See* David Jackson, *Madigan Goes After Mortgage Predators*, CHI. TRIB., Jan. 31, 2006, at 1.

181. *See* Homesavers Complaint, *supra* note 178, at 6.

182. *See id.* The suit alleged that Homesavers violated Illinois’s Consumer Fraud and Deceptive Business Practices Act and sought an injunction and \$50,000 for each infraction. *See id.* at 7-9.

183. *Id.* at 6.

claimed that Homesavers provided nothing more than “phantom help.”¹⁸⁴ Ultimately, Homesavers left homeowners in a worse financial position.¹⁸⁵

By implying that the majority of mortgage companies ignore Homesavers’s proposal,¹⁸⁶ the complaint raised the question of whether Homesavers provided a real benefit. Because Illinois’s statute allows a foreclosure consultant to receive the smaller of the sum of two monthly mortgage payments or the most recent tax installment on the property,¹⁸⁷ companies like Homesavers can obtain generous compensation for doing very little.¹⁸⁸

To test the effectiveness of recently enacted foreclosure-protection statutes, assume that Homesavers ceased practices that clearly violate the statutes by (1) not guaranteeing to save the home, (2) obtaining the homeowner’s signature on a written contract that conforms to all the statutes’ requirements, and (3) not receiving any compensation until it has performed its promises. None of the statutes regulate what foreclosure companies can promise to do. Therefore, a consumer suing Homesavers would have to resort to some other legal framework to establish liability.

Under contract law, “an ‘illusory promise’ appears to be a promise, but it does not actually bind or obligate the promisor to [do] anything [It] is composed of words in a promissory form that promise nothing.”¹⁸⁹ Surprisingly, a close look at case law reveals that an illusory promise is one that places no limitation on the freedom of the alleged promisor.¹⁹⁰ Thus, it would be impossible to conclude that Homesavers has made an illusory promise. While it obligates itself to take steps on behalf of the consumer, these steps are not worth much in terms of the likelihood that a mortgage company will agree to Homesavers’s proposal. Yet contract law does not judge the adequacy of the consideration, and, therefore, a homeowner would not prevail under an illusory-promise theory.¹⁹¹

184. *Id.*

185. *Id.* at 6-7.

186. *See id.* at 3-5.

187. 765 ILL. COMP. STAT. ANN. 940/50(a)(2) (West 2007).

188. *See supra* notes 143-47 and accompanying text (discussing how Homesavers received over \$24,000 as a consulting fee, although it would have been entitled to receive no more than \$2,000 under Illinois law).

189. *Holloman v. Circuit City Stores, Inc.*, 873 A.2d 1261, 1264 (Md. Ct. Spec. App. 2005).

190. *See Cheek v. United Healthcare of Mid-Atl., Inc.*, 835 A.2d 656, 662 (Md. 2003) (citing 1 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 4:24 (4th ed. 1993)).

191. Likewise, a plaintiff is not likely to prevail on a theory of promissory fraud because, in those cases, “a plaintiff must establish that the defendant did not intend to

A homeowner in a state that has a strong statute prohibiting unfair and deceptive acts and practices (UDAP) may be able to prove a consultant's violation.¹⁹² For example, Ohio's UDAP statute prohibits the commission of an unconscionable act or practice in connection with a consumer transaction.¹⁹³ It provides that, when determining whether an act or practice is unconscionable, the trier of fact must take into account "whether the supplier knew at the time the consumer transaction was entered into of the inability of the consumer to receive a substantial benefit from the subject of the consumer transaction."¹⁹⁴ In the context of foreclosure-rescue scams, without a track record of persuading mortgage companies to agree to its proposal, a consultant company knows at the outset that the homeowner likely will not receive a substantial benefit from its services. Absent the reasonable chance of mortgage companies accepting its proposal, Homesavers's promise to refer the homeowner to an attorney amounts to nothing.

2. DEFINE "KNOWLEDGE"

Although not directly related to a foreclosure, *Walker v. Dominion Homes, Inc.* addressed whether a defendant knew or should have known of the consumers' inability to receive a substantial benefit from a contract to purchase a home.¹⁹⁵ The plaintiffs, Frank and Lisa Walker, contacted Dominion Homes after seeing its advertisement of a "2-1 buydown" loan program which consisted of an adjustable-rate, thirty-year mortgage with a low starting interest rate.¹⁹⁶ The Walkers decided to buy a home from Dominion because they believed that they would

perform the promise when it was made." *Helmer v. Bingham Toyota Isuzu*, 29 Cal. Rptr. 3d 136, 143 (Ct. App. 2005). No evidence suggests that Homesavers did not intend to fulfill its promises.

192. See JONATHAN SHELDON & CAROLYN L. CARTER, UNFAIR AND DECEPTIVE ACTS AND PRACTICES § 1.1, at 1 (6th ed. 2004) ("All fifty states, the District of Columbia, Puerto Rico, Guam, and the Virgin Islands have enacted at least one statute with broad applicability to most consumer transactions Many of these statutes are patterned after the . . . the Federal Trade Commission (FTC) Act which prohibits 'unfair or deceptive acts or practices.'").

193. OHIO REV. CODE ANN. § 1345.03(A) (LexisNexis 2007); see also *infra* note 206.

194. OHIO REV. CODE ANN. § 1345.03(B)(3).

195. See 842 N.E.2d 570 (Ohio Ct. App. 2005). Additional lawsuits alleging lending and appraisal fraud are pending against Dominion Homes. See, e.g., Jill Riepenhoff, *2 Lawsuits Multiply Woes for Dominion: Action by Homeowners in Three Neighborhoods Could Affect Thousands*, COLUMBUS DISPATCH, Feb. 22, 2006, at 1A.

196. See *Walker*, 842 N.E.2d at 573.

qualify for this buydown loan through Dominion's mortgage division.¹⁹⁷ Until ten days before the closing, Dominion led the Walkers to believe that they qualified for the loan even though it knew that a loan officer had determined weeks earlier that the Walkers' low credit scores disqualified them for conventional financing in general and for the "2-1 buydown" loan program specifically.¹⁹⁸

After failing to convince Dominion to cancel the purchase contract, the Walkers sued, making numerous claims under Ohio's UDAP statute—including an unconscionability claim on the basis that Dominion knew that the Walkers would not receive a substantial benefit from its contract.¹⁹⁹ In overruling a grant of summary judgment in favor of Dominion and its mortgage division, the appellate court ruled that

a reasonable person could find that defendants knew at the time the parties executed the home-purchase agreement that the Walkers would be unable to receive financing under the 2-1 buydown program. Because the evidence establishes that the program was the primary reason the Walkers chose to contract with Dominion and the Walkers would not have contracted with Dominion had they known they would not qualify for the program, a reasonable person could find that the 2-1 buydown program was a substantial benefit to the Walkers in the purchase of their home.²⁰⁰

The *Walker* holding should be helpful to Ohio residents suing a foreclosure consultant on similar grounds.²⁰¹

From an evidentiary point of view, courts may have a difficult time deciding when a foreclosure consultant should have known that the homeowner would not have received a substantial benefit from its contract.²⁰² Assume, for example, that Homesavers produced evidence

197. *See id.* at 574.

198. *Id.* at 574-75.

199. *See id.* at 575-76; *see also* OHIO REV. CODE ANN. § 1345.03(B)(3).

200. *See Walker*, 842 N.E.2d at 579.

201. Ohio recently amended the unconscionability provision to exclude parties involved in a residential-mortgage transaction. *See* OHIO REV. CODE ANN. § 1345.03(C). This amendment may protect a foreclosure purchaser, but not a consultant, because a purchaser would probably be considered a dealer in intangibles, which is excluded from the definition of a consumer transaction. *See id.* § 1345.01(A) (defining consumer transaction); *id.* § 5725.01(B)(1) (defining dealer in intangibles).

202. A court could narrowly construe the Ohio UDAP statute because it does not read "likely or probable inability," but simply "inability." *See* OHIO REV. CODE ANN. § 1345.03(B)(3). In other words, a court could interpret the statute to mean that Homesavers must have known that there was no probability of a mortgage company agreeing to the proposal.

showing a 30 percent proposal-acceptance rate. A reasonable person, knowing about this low success rate at the outset, may have chosen not to pay \$900 to Homesavers. An unsympathetic judge,²⁰³ however, could conclude that Homesavers did not commit an unconscionable act because a 30 percent success rate could have resulted in a proposal's acceptance. Depending on a court's interpretation, the plaintiff may be required to show Homesavers had an extremely low success rate to prove unconscionability. Because a homeowner may not be in a jurisdiction with a strong UDAP statute backed by liberal case-law interpretation,²⁰⁴ a more effective foreclosure-protection statute should prohibit phantom help.

3. VERIFY A HOMEOWNER'S ABILITY TO PAY

In keeping with the theme of prohibiting phantom help, an effective foreclosure statute should also require the consultant to determine that the homeowner can make the required mortgage payments before submitting the proposal to a lender. In the lawsuit against Homesavers, Madigan alleged that the company submitted proposals with mortgage payments in amounts greater than the homeowner's payments prior to the initiation of the foreclosure proceedings.²⁰⁵ Attached to the complaint was a Homesavers proposal that listed the existing mortgage payment as \$577 and proposed monthly payments of \$777 until the homeowner paid an arrearage totaling \$3,691.²⁰⁶ It is unclear how, or even if, Homesavers determined whether the homeowner could actually make the increased monthly payment.

No foreclosure statutes require the consultant to determine whether the homeowner can actually make the proposed payments. Without such a requirement, foreclosure consultants could receive compensation for creating proposals that are doomed to fail. Moreover, because the proposals come after the commencement of foreclosure proceedings, a

203. See Cox, *supra* note 7, at 620 ("Many judges instinctively look only at the face of the executed real estate documents and dismiss a fraud or UDAP claim.").

204. See SHELDON & CARTER, *supra* note 192, § 1.1, at 1 (suggesting that uniformity of protection does not exist among the states).

205. Homesavers Complaint, *supra* note 178, at 6 ("In at least one case, defendants represented that the consumer's monthly mortgage payment would be lowered, when in fact defendants proposed a higher monthly mortgage payment."). See generally Phillip Robinson, *Litigating Foreclosure Rescue Scams*, MD. BAR BULLETIN, Apr. 2006, at 2, available at http://www.msba.org/departments/commpubl/publications/bar_bult/2006/apr/scams.htm (discussing a lawsuit filed against a purchaser who tried to convince a homeowner to sign a sale-lease-back contract that required monthly rental payments of over \$1,900—which was \$600 more than her monthly income).

206. Homesavers Complaint, *supra* note 178, at exh. F.

reputable lender will ignore proposals lacking evidence (for example, copies of recent pay stubs) showing that the homeowner has the ability to cure the default and make the mortgage payments.²⁰⁷

Conversely, six statutes mandate that a foreclosure purchaser verify that the homeowner has a reasonable ability to make payments required under the lease agreement or to repurchase the home under a buy-back option agreement.²⁰⁸ Additionally, most of these statutes require the foreclosure purchaser to base its verification on a review of third-party documentation of the homeowner's assets, liabilities, and income.²⁰⁹

The statutes in Colorado, Maryland, Minnesota, and Rhode Island contain a rebuttable presumption that a homeowner is reasonably able to pay if the homeowner's primary housing expenses together with other regular principal and interest payments on personal debt do not exceed 60 percent of the homeowner's gross monthly income.²¹⁰ Under New York's rebuttable-presumption test, however, the expenses cannot exceed 50 percent of the homeowner's gross monthly income.²¹¹ The debt-to-income-ratio test makes determining the reasonable ability to pay easier for the foreclosure purchasers, but it requires an unrealistically high percentage.²¹² Because the test is based on gross—rather than net—income, an individual could pass the test without having sufficient disposable income to cover all expenses after taxes and other mandatory deductions.²¹³ For example, 60 percent of a \$40,000 per year income is \$24,000. Consumer advocates assert that the debt-to-income-ratio presumption should be lowered to 41 percent.²¹⁴

207. See NAT'L CONSUMER LAW CTR., *supra* note 155, at 193.

208. See COLO. REV. STAT. ANN. § 6-1-1115(1)(d) (West Supp. 2006); 765 ILL. COMP. STAT. ANN. 940/50(b)(1) (West Supp. 2007); MD. CODE ANN., REAL PROP. § 7-311(b)(1)(i) (LexisNexis Supp. 2006); MINN. STAT. ANN. § 325N.17(a)(1) (West Supp. 2007); N.Y. REAL PROP. LAW § 265-a(11)(b)(i) (McKinney Supp. 2007); R.I. GEN. LAWS § 5-80-8(a)(1) (Supp. 2006).

209. See 765 ILL. COMP. STAT. ANN. 940/50(e); MD. CODE ANN., REAL PROP. § 7-311(c)(2); MINN. STAT. ANN. § 325N.17(a)(1); N.Y. REAL PROP. LAW § 265-a(11)(b)(i); R.I. GEN. LAWS § 5-80-8(a)(1).

210. See COLO. REV. STAT. ANN. § 6-1-1115(1)(d); MD. CODE ANN., REAL PROP. § 7-311(c)(1); MINN. STAT. ANN. § 325N.17(a)(1); R.I. GEN. LAWS § 5-80-8(a)(1).

211. See N.Y. REAL PROP. LAW § 265-a(11)(b)(i); N.Y. BANKING LAW § 6-1(2)(k) (McKinney Supp. 2007).

212. See Engel & McCoy, *supra* note 57, at 1370 (criticizing New York's 50 percent debt-to-income-ratio presumption).

213. See *id.* Moreover, a homeowner with a \$16,000 gross annual income and a poor credit score as a result of default and foreclosure most likely will not be able to qualify for financing to meet the onerous buyback prices typically set out in foreclosure-purchase agreements. See TRIPOLI & RENUART, *supra* note 8, at 8; see also NAT'L CONSUMER LAW CTR., *supra* note 155, at 114-15.

214. See Engel & McCoy, *supra* note 57, at 1369-70.

The states' use of a numerical presumption is problematic. Legislatures evidently borrowed the test from recent predatory-lending statutes, which prohibit asset-based lending for high-cost loans and require an assessment of the borrower's ability to pay.²¹⁵ Advocates and banking regulators were alarmed by subprime lenders' focus on the value of collateral rather than a borrower's ability to repay.²¹⁶ Subprime lenders extend credit to borrowers characterized by one of several factors—including having a debt-to-income ratio of at least 50 percent²¹⁷—and research shows that these borrowers have a high probability of defaulting on a loan.²¹⁸

The homeowners targeted by foreclosure companies have already defaulted and are in the process of foreclosure. Because these companies claim to “rescue” homeowners, states should not give them the luxury of judging a homeowner's ability to pay based on an artificial test.²¹⁹ Instead, states should require rescue companies to consider the homeowner's net income and expenses after a review of third-party documentation of the homeowner's assets, liabilities, and income. Otherwise, the foreclosure-protection statute may only act to delay the inevitable.

215. See, e.g., GA. CODE ANN. § 7-6A-5(8) (2004) (“There is a rebuttable presumption that the borrower residing in the home is able to make the scheduled payments to repay the obligation if, at the time the loan is consummated, said borrower's total monthly debts, including amounts under the loan, do not exceed 50 percent of said borrower's monthly gross income . . .”). For a discussion of some of these regulations, see Daniel S. Ehrenberg, *If the Loan Doesn't Fit, Don't Take It: Applying the Suitability Doctrine to the Mortgage Industry to Eliminate Predatory Lending*, 10 J. AFFORDABLE HOUSING & COMMUNITY DEV. L. 117, 118 (2001).

216. See Kathleen C. Engel & Patricia A. McCoy, *Turning a Blind Eye: Wall Street Finance of Predatory Lending*, 75 FORDHAM L. REV. 2039, 2093-94 (2007) (“[T]he recent spate of interest-only and option adjustable-rate mortgages made without regard for the borrowers' ability to repay so alarmed federal banking regulators in 2006 that they issued a guidance curbing abusive practices in nontraditional mortgages.”).

217. See Chiwon Yom, *Limited-Purpose Banks: Their Specialties, Performance, and Prospects*, 17 FDIC BANKING REV. 19, 25 n.4 (2005) (“The bank regulatory agencies have recently suggested that any of the following may indicate a subprime borrower: (1) a FICO credit score of 660 or below; (2) two or more thirty-day delinquencies during the past year; (3) bankruptcy within the last five years; (4) judgment, foreclosure, repossession, or charge-offs in the prior twenty-four months; or (5) debt service-to-income ratio of 50 percent or greater.”).

218. See OFFICE OF THE COMPTROLLER OF THE CURRENCY ET AL., EXPANDED GUIDANCE FOR SUBPRIME LENDING PROGRAMS 2-3 (1999), <http://www.federalreserve.gov/boarddocs/SRLETTERS/2001/sr0104a1.pdf>.

219. See generally Cox, *supra* note 7, at 613 (stating that foreclosure purchasers rarely engage “in any form of underwriting to determine if the foreclosed homeowner has the capacity to meet the obligations required” and, “[i]n some cases, [purchasers] design the plan to fail so that they can take control of the property and liquidate remaining equity”).

4. PREVENT REPRESENTATIONS THAT GUARANTEE A CERTAIN RESULT

Lawmakers considering effective legislation should also prohibit the foreclosure-rescue companies from making oral representations or using contract language that guarantees a certain result, such as saving a home or securing a refinancing loan. Although consumer-vulnerability research²²⁰ supports such prohibitions and they are necessary given that numerous homeowners have fallen for fraudulent rescue claims,²²¹ only two state statutes presently contain them.²²² Prohibiting guarantees would be in line with the goal of prohibiting rescue companies from promising phantom help.

5. REQUIRE CONSULTANTS TO DISCLOSE THE POSSIBILITY OF FORECLOSURE

Legislators should also require consultants to disclose that, despite any representations, homeowners could lose their homes. Even if companies like Homesavers ceased to expressly guarantee the ability to save a home,²²³ their names often imply such an ability.²²⁴ Consequently, states should require foreclosure-rescue companies to obtain a homeowner's initials next to a conspicuous disclosure explaining the potential loss of the home despite entrance into a foreclosure contract.

220. See *supra* notes 91-93 and accompanying text (discussing research demonstrating that consumers facing negative life events are more vulnerable to a con artist's claims).

221. Numerous rescue companies, however, have been sued or have come under fire, and their practices have affected large numbers of homeowners. See, e.g., TRIPOLI & RENUART, *supra* note 8, at 16 (stating that California recently obtained a judgment against a sham "rescue" operation); April M. Washington, *Bill Targets Investors Who Bilk Homeowners*, ROCKY MOUNTAIN NEWS (Denver), Feb. 7, 2006, at 16A (stating that, according to Colorado Attorney General John Suthers, mortgage fraud was on the top-ten list of consumer complaints filed with his office in 2005); Iwata, *supra* note 16, at B6.

222. See COLO. REV. STAT. ANN. § 6-1-1104(5) (West Supp. 2007); MD. CODE ANN., REAL PROP. § 7-306(a)(5) (LexisNexis Supp. 2006).

223. Two states require this. See COLO. REV. STAT. ANN. § 6-1-1114(5) (West Supp. 2006); MD. CODE ANN., REAL PROP. § 7-306(a)(5) (LexisNexis Supp. 2006).

224. Several companies have names that create the impression that they can save a person's home from foreclosure. See, e.g., Saveyourhouse.com Stops Foreclosure, <http://www.saveyourhouse.com/> (last visited June 11, 2007); *supra* notes 27-35 and 178-86 and accompanying text (discussing lawsuits against Homesavers USA and Homesavers Group, LLC—both suspected of perpetrating foreclosure fraud).

C. Establish an Incentive-Based Disclosure System that Directs Homeowners to Legitimate Foreclosure-Intervention Specialists

Recently enacted foreclosure-protection statutes primarily require full disclosure to homeowners of contractual terms but prohibit some practices.²²⁵ While full disclosure may prevent some homeowners from contracting with foreclosure-rescue companies, these companies can still dupe others with illusory promises. As long as these companies meet the minimum statutory disclosure requirements, they will continue to trick some homeowners into accepting contractual terms that are most likely detrimental to their interests. Therefore, states should implement a rating system for companies in the foreclosure-intervention business and use a city's 311 system to steer homeowners away from con artists and towards companies passing the rating standards.

1. RATINGS AS INCENTIVE-BASED DISCLOSURE SYSTEMS

a. The New Car Assessment Program

The most remarkable and influential use of an incentive-based disclosure system has been the federal government's New Car Assessment Program (NCAP).²²⁶ The goal of NCAP is to "encourage market forces that prompt vehicle manufacturers to make safety improvements to new vehicles and provide the public with objective information on the relative safety performance of vehicles."²²⁷ To carry out NCAP's mandate, the National Highway Traffic Safety Administration (NHTSA) tests various vehicle safety features and then rates them on a five-star scale, assigning four or five stars to vehicles surpassing the basic safety standard, three stars to vehicles meeting the standard, and one to two stars to vehicles falling below the standard.²²⁸

Although no law requires a manufacturer to produce vehicles that achieve a certain rating,²²⁹ NCAP has drastically changed the auto industry (particularly the importance it places on safety) over the past twenty-seven years. For example, in 1979, 37 percent of vehicles received a one-star rating for the driver-frontal-impact test and 47

225. See *supra* notes 111-41 and accompanying text (describing the obligations of consultants and purchasers under the foreclosure-protection statutes).

226. See DOUGLAS, *supra* note 26, at 1.

227. *Id.* at 8 (quoting GOV'T ACCOUNTABILITY OFFICE, VEHICLE SAFETY: OPPORTUNITIES EXIST TO ENHANCE NHTSA'S NEW CAR ASSESSMENT PROGRAM 1 (2005), <http://www.gao.gov/new.items/d05370.pdf>).

228. *Id.*

229. *Id.* at 9.

percent received a one-star rating for the passenger-frontal-impact test; but in 2006, no vehicles received a one- or two-star rating for those tests and over 50 percent of the vehicles received a five-star rating.²³⁰ While this dramatic increase in safety can be linked to technological advances, it can clearly be traced to the incentive-based compliance system created by NCAP.²³¹

Initially, disclosure of the safety ratings was voluntary, even though advertisements regularly used high ratings as a selling point.²³² The NHTSA recently promulgated the “Stars on Cars” regulation, however, which requires all manufacturers to display the star rating received for each of the safety tests performed on the vehicle.²³³ Under this regulation, automobile consumers can easily evaluate how well each vehicle protects its occupants in the event of a crash. Auto manufacturers now have a greater incentive to make safer vehicles and to submit their vehicles to NHTSA’s safety test.

b. The National Credit Card Assessment Program

Because NCAP has been such a successful incentive-based safety system, commentators have explored developing similar systems in other industries in which consumer safety is at risk. For example, policymaker Derek Douglas of the Center for American Progress has recommended adopting an incentive-based disclosure system for the credit-card industry.²³⁴ Instead of NCAP’s five-star rating program, Douglas’s National Credit Card Assessment Program (NCCAP) would use a color-coded system which would grant a green rating to cards exceeding the safety standard, a yellow rating to cards meeting the standard, and a red rating to cards falling below the standard.²³⁵ NCCAP would test the most dangerous practices of the credit-card industry by studying the contracts drafted by the credit-card companies to govern their agreements with

230. *Id.* at 10. Also, from 1979 to 2006, the percentage of five-star rated cars for the frontal-impact test increased from 3 to 57 percent. *Id.* at 1. Furthermore, from 1997 to 2006, the percentage of five-star rated cars for the side-impact test increased from 4 to 54 percent, and the percentage of one- and two-star rated cars fell from 28 to 1 percent *Id.* Lastly, from 2000 to 2006, the percentage of four- and five-star rated cars for rollover-resistance testing increased from 32 to 75 percent, and the percentage of one- and two-star rated cars dropped from 23 to 1 percent. *Id.* at 2.

231. *See id.* at 2.

232. *See id.* at 9.

233. *See* 49 C.F.R. § 575.301(d) (2006).

234. *See* DOUGLAS, *supra* note 26, at 14.

235. *Id.*

consumers,²³⁶ and would require these companies to disclose the ratings on the cards.²³⁷ In order for NCCAP to work, the public would need to be educated about the program and its benefits.²³⁸

2. THE PROPOSAL: THE FORECLOSURE INTERVENTION SERVICES ASSESSMENT PROGRAM

Laws regulating the credit-card industry are similar to the foreclosure-protection statutes in that they act as a punitive disclosure regime. As long as credit-card and foreclosure-rescue companies meet the minimum disclosure regulations, they will still be able to deceive some consumers into agreeing to onerous contract provisions. Based on the proposed NCCAP, this Article recommends that states establish a similar program for the foreclosure-intervention industry called the Foreclosure Intervention Services Assessment Program (FISAP). An incentive-based disclosure system would prove beneficial to consumers in need of foreclosure or mortgage-default assistance. The consumer-protection division of a state's attorney-general office could administer the program. A green-yellow-red rating system would alert consumers of each foreclosure-intervention company's performance.

FISAP would rate various categories, including an organization's (1) years in the foreclosure-intervention business, (2) success rate in preventing foreclosures, (3) compliance with state laws, (4) method of delivering foreclosure-intervention services, and (5) actual services. The program would give a green, yellow, or red rating to each of these categories, which would translate to a number system in which green corresponds to three, yellow corresponds to two, and red corresponds to one.

The summation of the numbers from all five categories would determine the overall rating for the business. Therefore, the most a business could receive would be fifteen (if it received a green rating in every category), and the least a business could receive would be five (if it received a red rating in every category). To be a green business, the organization would have to obtain an overall number rating of at least

236. *See id.* at 14-15.

237. *Id.* at 17. Furthermore, Douglas's proposal states that the credit-card contract should indicate the maximum possible rating and describe the meaning of each safety test and the colored ratings. *Id.*

238. *Id.* at 18.

thirteen combined with no red ratings in any category.²³⁹ To be a yellow business, an organization would need at least an overall number rating of ten with no red ratings in any category.

FISAP would classify organizations that receive a number rating of nine or below or that receive a red rating in any category as a red company. An organization that falls beneath these standards can bring serious detriment to homeowners and leave them worse off than before they began the foreclosure-assistance process. An organization with a red rating would not be able to obtain referrals under a 311 mortgage hotline.²⁴⁰

The first rated category is the number of years a company has been in the foreclosure business. It follows that the more years a company has been in the foreclosure-intervention business, the more experienced and adept it should be in helping homeowners facing foreclosure. FISAP should establish a minimum-experience requirement of two years.²⁴¹ Therefore, an organization that has been providing foreclosure-intervention services for at least two years would receive a yellow rating. In order to receive a green rating, a company would need five years of experience. A company in business for less than two years would receive a red rating. Start-up companies would, therefore, have an overall red rating for the first two years of their existence. This waiting period is necessary to enable regulators to gather enough information to adequately assess the company's legitimacy and effectiveness.

The second category is the organization's overall success in helping consumers avoid foreclosure. Nonprofit organizations will have an advantage in this category because many of them have the ability to issue monetary grants to homeowners in need of temporary mortgage-payment assistance.²⁴² The for-profit companies could bolster their success rate by

239. For example, a business could receive a green rating in years in foreclosure business, success rate, and compliance with state laws and a yellow rating in method of delivery and actual services and still be a green-rated business because its overall number rating would be thirteen.

240. See *infra* Part IV.C.2.

241. This is based on one of several standards adopted by the United States Trustee's Office, which set guidelines for approving nonprofit credit-counseling agencies to offer prebankruptcy counseling to consumer debtors. See EXECUTIVE OFFICE FOR U.S. TRS., U.S. DEPARTMENT OF JUSTICE, INSTRUCTIONS FOR APPLICATION FOR APPROVAL AS A NONPROFIT BUDGET AND CREDIT COUNSELING AGENCY 3 (2006), http://www.usdoj.gov/ust/eo/bapcpa/ccde/docs/CC_Application_Instructions.pdf.

242. See, e.g., HELEN JONES, CITY OF SPOKANE CONTINUUM OF CARE PLAN FOR THE HOMELESS 12 (2004), <http://www.spokanehumanservices.org/reports/2004ContinuumofCarePlanv7-21-04.pdf> (reporting that the Spokane Neighborhood Action Program provides low-income homeowners with temporary monetary assistance with mortgage payments and that "[f]ederal guidelines are used to qualify about 180 families each year"); News Release, Homeownership Pres. Found., Homeownership

publicizing their ability to persuade lenders to forgive part of the homeowner's debt or accept reduced mortgage payments.²⁴³ In order to receive a green rating for its overall success rate, an organization should have to demonstrate that at least 60 percent of its clients have become current on their mortgage payments or entered into a workout deal resulting in the lender's dismissal of foreclosure proceedings. A recent foreclosure-intervention initiative has been successful in helping nearly two-thirds of borrowers avoid foreclosure,²⁴⁴ therefore, a success rate of 60 percent or more is attainable. To receive a yellow rating, a company should have a success rate of 40 to 59 percent. Any company having a success rate below 40 percent would receive a red rating.

The third category is compliance with applicable federal and state laws.²⁴⁵ To earn a green rating in this category, a foreclosure business must demonstrate its compliance with laws, regulations, and bonding requirements.²⁴⁶ To obtain a yellow rating, the business would need to comply with all applicable laws but would not have to meet the bonding requirements. A red-rated company would fail to be in compliance with two or more applicable laws.

The fourth category is the method of delivery. The three primary methods of delivery are the Internet, the telephone, and in person. To

Preservation Foundation Partners with USA Cares (Nov. 14, 2005), http://www.hpfonline.org/PDF/News_Release-HPF_USA_Cares_Partnership.pdf ("USA Cares will provide emergency grants of up to \$7,500 to military families The purpose of each grant is to help a military family avoid foreclosure of their home due to financial struggles brought on by military service . . .").

243. See generally Markels, *supra* note 48, at 57 (stating that, in a cooling market, lenders may "be willing to restructure the loan or reduce payments in the short run if the borrower makes them up later").

244. See J. MICHAEL COLLINS, POLICYLAB CONSULTING GROUP, LLC, AN INTERIM REPORT ON CHICAGO'S DEFAULT INTERVENTION COUNSELING INITIATIVES 4 (2005), <http://www.hpfonline.org/PDF/HOPI-Interim-0311-WorkshopReport-Jun2014.pdf> (reporting on an a foreclosure-intervention initiative the City of Chicago established in partnership with nonprofit organizations and subsidized in part by lenders).

245. This rating category comes from the U.S. Trustee's Program, which requires an approved credit-counseling agency be in compliance with all applicable federal laws and regulations for each state in which it operates. See EXECUTIVE OFFICE FOR U.S. TRS., *supra* note 241, at 3-4.

246. Even if there is no applicable law related to bonding, a foreclosure-intervention firm should obtain a surety bond for its business operations to ensure that proper business procedures are in place and that clients have adequate recourse if they become victims of fraud. The surety bond should be payable to the state where the foreclosure business conducts most of its business and should be the lesser of 2 percent of the business's prior-year disbursements made from client trust accounts, or the average daily balance maintained in all client trust accounts for the six months prior to submission of the application. The surety amounts are borrowed from the U.S. Trustee's credit-counseling regulations and can be changed as different states deem necessary. See *id.* at 6.

receive a green rating, the foreclosure-intervention business must provide in-person services, although it could conduct its initial intake over the Internet or telephone. Research shows that some homeowners prefer face-to-face counseling, and companies use this method of delivery more often than telephone counseling.²⁴⁷ To receive a yellow rating, the company must counsel homeowners by both the Internet and telephone and provide a way for them to easily transmit copies of relevant documents. Lastly, a company would receive a red rating if it provides counseling by only the Internet or telephone.

The fifth category considers the actual services that the foreclosure-intervention firm provides—namely, (1) the extent of training the firm’s employees have received, and (2) the extent and depth of the services provided to clients. Effective training would ensure that employees understand the circumstances that trigger default and how to effectively deal with those that were either beyond the homeowner’s control or due to the homeowner’s financial mistakes. This would enable employees to determine whether short- or long-term solutions are available to address the homeowner’s financial crisis. Proper training would also prepare employees to identify predatory subprime-lending terms and to explain to the homeowner when to reject a refinance loan that contains onerous terms. Furthermore, companies should train employees about all the alternatives to foreclosure, the advantages and disadvantages of each, and how to help guide the homeowner to the best alternative. Lastly, employees designated as foreclosure- or default-intervention specialists should have received formal foreclosure training and certification from reputable educators, such as NeighborWorks and Home Ownership Matters.²⁴⁸ A firm would receive a green rating if its employees have completed training and certification from such educators. The Internet is rife with companies providing questionable foreclosure training,²⁴⁹ which

247. See, e.g., J. MICHAEL COLLINS, POLICYLAB CONSULTING GROUP, LLC, EXPLORING THE DESIGN OF FINANCIAL COUNSELING FOR MORTGAGE BORROWERS IN DEFAULT 1 (2006), <http://www.nhschicago.org/downloads/9729SurveySummary.pdf> (stating that, while some homeowners rate telephone and in-person counseling highly, low-income homeowners rate the more frequently used in-person counseling highly).

248. NeighborWorks offers several courses to give foreclosure specialists the training they need to provide effective assistance to homeowners facing foreclosure. See NeighborWorks Am., NeighborWorks America Course Catalog, <http://nw.org/network/training/courses/default.asp> (follow “Homeownership and Community Lending” hyperlink) (last visited June 24, 2007); see also Home Ownership Matters, <http://www.homeownershipmatters.com/f&lm/fis%20homepage.htm> (last visited June 24, 2007) (offering training and certification for foreclosure-intervention specialists).

249. See, e.g., Welcome to ForeclosureTraining.com, <http://www.foreclosuretraining.com> (last visited June 11, 2007) (“At Foreclosure Training, we want you to take advantage of this hidden key to a better life We’ve

is most likely insufficient to prepare someone to offer effective foreclosure-intervention counseling. Therefore, FISAP would need to examine employee training received from organizations to determine which rating a firm should receive.

In addition to rating the training level of a foreclosure-intervention firm's employees, FISAP would also evaluate the effectiveness of a firm's services by examining the extent of its counseling, budgeting, advocacy, financial assistance, and referral networks.²⁵⁰ Counseling overlaps somewhat with proper employee training in that evaluation requires assessing the reasons for delinquency, identifying short- and long-term options for the homeowner, and assisting the homeowner in choosing the best option.²⁵¹ Budgeting refers to assisting homeowners in prioritizing their finances and providing them with financial training.²⁵² Advocacy involves actually helping and supporting the homeowner in workout negotiations with the lender by persuading the lender to agree to several options.²⁵³ Financial assistance refers to whether the foreclosure-intervention business provides mortgage-payment assistance in the form of grants or interest-free loans that homeowners can use to catch up on their mortgage payments.²⁵⁴ Most for-profit companies will not be able to meet this portion of the actual-services test because they do not provide financial assistance to homeowners in distress. They could, however, forgive part of the mortgage-default arrearage when the homeowner has demonstrated the likelihood of successfully resuming mortgage payments. Finally, referral networks measures the extent to which the foreclosure-prevention business has established governmental and community-based networks to direct homeowners to employment agencies, mental-health counseling, domestic-violence services, and other counseling to remedy issues that led to default.²⁵⁵

In order for a company to obtain a green rating in the actual-services category, it must pass both the training and the effective-counseling

collected the best and most effective methods of making fortunes in foreclosures, from some of the most successful authors in the industry."); Foreclosure University, <http://www.foreclosureuniversity.com> (last visited June 11, 2007) ("Discover a proven system for buying real estate foreclosures 20 percent, 30 percent, and 40 percent under market. Generate huge returns using this step-by-step foreclosure system!").

250. These areas of examination are based on a list contained in ALLAN MALLACH, HOME OWNERSHIP EDUCATION AND COUNSELING: ISSUES IN RESEARCH AND DEFINITION 25 tbl.6 (2000), <http://www.phil.frb.org/cca/capubs/homeowner.pdf>.

251. *See id.*

252. *See id.*

253. *See id.*

254. *See id.*

255. *See* MALLACH, *supra* note 250, at 25 tbl.6. Referral networks would also include the foreclosure firm's ability to connect the homeowner with organizations that can provide financial assistance to meet financial emergencies. *See id.*

prongs. Regulators in charge of rating this category should seek input from reputable professionals in the foreclosure-intervention business to make appropriate determinations.

The color rating system is a means to provide homeowners facing foreclosure with a way of determining which organizations offer effective foreclosure-intervention services. For it to be an effective incentive-based disclosure system, however, foreclosure-intervention businesses have to be motivated to submit to the rating process. This can be accomplished in several ways. First, once the rating system has been in place long enough for some foreclosure-intervention businesses to receive ratings, FISAP should launch a media campaign to make the public aware of the rating system as a means of finding legitimate businesses.²⁵⁶ The agency in charge of the rating system would make available to the public (via the Internet and telephone) a list containing the names and contact information for green- and yellow-star businesses. Second, statutes should obligate the county clerks for the court in which a foreclosure proceeding has been filed to send this list to the homeowner along with an informative letter about foreclosure scams and warning them to avoid dealing with businesses that have not achieved satisfactory ratings.²⁵⁷

3. 311 CALL CENTER DIRECTS HOMEOWNERS TO HIGHLY RATED FIRMS

Besides using a media-awareness campaign and local county clerks, cities should utilize their 311 telephone systems as a default intervention hotline to give foreclosure-intervention firms another incentive to submit to the rating system. The 311 operators would refer callers experiencing mortgage-payment problems to only green- or yellow-rated firms. This would also make the public aware of businesses that provide legitimate services and encourage homeowners who are about to or have recently defaulted on their mortgages to obtain timely help.²⁵⁸

Baltimore developed the first 311 call system in 1996 to relieve the city's 911 system of nonemergency calls, and at least twenty-four cities have followed suit.²⁵⁹ The system answers questions that callers might have about nonemergency problems and directs them to various

256. Cf. DOUGLAS, *supra* note 26, at 18 (recommending a media campaign to make consumers aware of NCCAP).

257. If the foreclosure proceeding is nonjudicial, the foreclosing lender should have to provide the homeowner with this information.

258. Employed homeowners who have recently defaulted on their mortgages may qualify for grants providing temporary assistance with mortgage payments and, therefore, never have a foreclosure proceeding filed against them.

259. Ric Kahn, *311 to the Rescue*, BOSTON GLOBE, Apr. 30, 2006, at 1.

governmental agencies that can assist callers with their problems.²⁶⁰ Chicago, which has the premier 311 system in the United States,²⁶¹ decided to use its system to address its rising foreclosure problem by offering assistance to at-risk consumers.²⁶² Mayor Richard Daley led a widely publicized campaign to encourage the system's use by distressed homeowners.²⁶³

One of the goals of Chicago's 311 hotline was to help 1,500 distressed borrowers avoid foreclosure on their homes.²⁶⁴ The slogan for the mass-media campaign is "Every Minute Counts. Difficulty paying your mortgage? Understand your options. Call 3-1-1 City Services today."²⁶⁵ If a 311 caller has a mortgage- or foreclosure-related problem, the operator transfers the call to a counselor from the Credit Counseling Resource Center (CCRC)—a national alliance of housing-counseling agencies certified by the U.S. Department of Housing and Urban Development and operated by the Home Ownership Preservation Foundation (HOPF).²⁶⁶ The counseling is free to the caller because

260. *See id.*

261. Carl Fillichio, *Chicago 311: A 24/7 Telephone and Online Customer Service Center*, PUB. MANAGER, Sept. 22, 2003, at 52 Cities across the country are emulating Chicago's system. *See id.*

262. *See* COLLINS, *supra* note 244, at 3. Chicago's 311 mortgage-default-hotline initiative is part of Chicago's Home Ownership Preservation Initiative which is "a unique partnership among Neighborhood Housing Services, Inc. of Chicago, the City of Chicago, the Federal Reserve Bank of Chicago, the nation's leading financial institutions and other non-profit and industry leaders." *Id.* at 1. In contrast, New York has established a 311 mortgage-default hotline only for residents of the communities of Southeast Queens, Bedford-Stuyvesant, and Bushwick because they have particularly high foreclosure rates. *See* UNIV. NEIGHBORHOOD HOUS. PROGRAM, THE STATE OF HOMEOWNERSHIP IN THE BRONX, SUB-PRIME LENDING, FORECLOSURES, AND GAPS IN HOMEOWNERSHIP PRESERVATION 6 (2006), <http://www.unhp.org/pdf/StateHomeBronx.pdf>.

263. WILLIAM C. APGAR ET AL., HOME OWNERSHIP PRES. FOUND., THE MUNICIPAL COST OF FORECLOSURES: A CHICAGO CASE STUDY 4 (2005), <http://www.nw.org/network/neighborworksProgs/foreclosuresolutions/documents/2005Apgar-DudaStudy-FullVersion.pdf>. Chicago sent 65,000 postcards to high-foreclosure neighborhoods and funded the placement of advertisements on 200 elevated-train lines. *See, e.g.*, HOME OWNERSHIP PRES. INITIATIVE, PARTNERSHIP LESSONS & RESULTS: THREE YEAR FINAL REPORT 21 (2006), http://www.nhschicago.org/downloads/82HOPI3YearReport_Jul17-06.pdf.

264. Rochelle Nawrocki Gorey, *Protecting Families, Transforming Houses*, BRIGHT IDEAS, Spring, 2005, at 38, 38, available at <http://www.nw.org/network/pubs/brightIdeas/documents/initiative.pdf>; HOME OWNERSHIP PRES. INITIATIVE, *supra* note 311, at 6 tbl.1.

265. NEIGHBORHOOD HOUS. SERVS. OF CHICAGO, INC., MID TERM REPORT FOR THE CHICAGO HOMEOWNERSHIP PRESERVATION INITIATIVE 13, <http://nw.org/network/neighborworksProgs/foreclosuresolutions/documents/HOPImidtermreport.pdf>.

266. HOME OWNERSHIP PRES. INITIATIVE, *supra* note 263, at 12.

lenders (in partnership with the city) pay for at least 60 percent of the credit-counseling sessions, and a HOPF grant pays for the remaining 40 percent.²⁶⁷

Evaluators consider Chicago's program to be successful given its transfer of 4,328 callers to CCRC counselors in three years.²⁶⁸ Chicago's foreclosure-prevention initiative, in conjunction with the 311 hotline, has saved homeowners, lenders, and the city over \$267 million in a three-year span²⁶⁹ and has helped 1,304 homeowners avoid foreclosure.²⁷⁰

Other cities should use Chicago as a model because many homeowners experiencing mortgage-payment problems are reluctant to speak to lenders. Research demonstrates that the majority of homeowners experiencing default or foreclosure are unaware of alternatives to foreclosure and that many homeowners are distrustful of lenders and never contact them.²⁷¹ As many as 61 percent of homeowners are unaware of the variety of workout options.²⁷² Also, "53 percent of homeowners would not contact their mortgage company for help with missed mortgage payments."²⁷³ These statistics are consistent with those from the 2005 Chicago Mortgage Default Counseling Survey, which reported that 36 percent of homeowners making late payments had never contacted their lenders.²⁷⁴ Many homeowners view phone calls or letters from lenders as collection inquiries and believe that, if they contact their lenders about mortgage-payment problems, the lenders will speed up the foreclosure process.²⁷⁵

Although not receptive to lenders, many homeowners are willing to seek help from nonprofit organizations because they believe that

267. *Id.*

268. *See, e.g., id.* at 1, 6 tbl.1.

269. *Id.* at 8 tbl.2.

270. *Id.* at 6 tbl.1.

271. In one study, 48 percent of homeowners rated the willingness of lenders to help them as "low," and only 9 percent rated their willingness to help as "high." *Id.* at 24.

272. Press Release, Freddie Mac, Freddie Mac, Roper Poll Survey Asks Why More Delinquent Borrowers Don't Call Lenders for Help (Dec. 12, 2005), http://www.freddie.com/news/archives/corporate/2005/20051212_ropersurvey.html; *see also* HOME OWNERSHIP PRES. INITIATIVE, *supra* note 263, at 23 (stating that 48 percent of homeowners making late payments have never contacted their lenders).

273. Press Release, Stephen Dupont, Homeownership Pres. Found., Six Steps to Avoid Foreclosure on Your Dream Home (Feb. 2, 2006), http://www.hpfonline.org/PDF/News_Release-Steps_for_Avoiding_Foreclosure.pdf.

274. *See* HOME OWNERSHIP PRES. INITIATIVE, *supra* note 263, at 23.

275. Heidi S. Coppola, *Reducing Foreclosures Through Nonprofit Partnerships*, COMMUNITY DEV., Spring 2006, <http://www.occ.gov/cdd/spring06b/cd/reducingforeclosure.htm>; *see also* HOME OWNERSHIP PRES. INITIATIVE, *supra* note 263, at 25 fig.7 (reporting that 45 percent of borrowers did not contact the lender because they "did not think the lender would care").

nonprofits are on their side.²⁷⁶ As such, 311 operators should be trained in foreclosure intervention and should direct homeowners not only to green- or yellow-rated businesses, but also to any other appropriate resources available in the community. A 311 mortgage-default hotline used in conjunction with the color rating system would assure homeowners that they are receiving assistance from organizations with successful track records.²⁷⁷

Local governments and lenders should be involved in supporting the proposed system because they both benefit when homeowners are able to avoid foreclosure.²⁷⁸ When local governments are active in sustaining home ownership, they can market themselves to attract new residents, increase property-assessment values for tax-revenue purposes, and stabilize local economies.²⁷⁹ Likewise, lenders can avoid tying up the \$44,000 to \$58,000 expended for each completed foreclosure, which can take twelve to eighteen months to resolve.²⁸⁰ In light of the research showing that homeowners are unreceptive to lenders, lenders should assist homeowners experiencing mortgage-payment problems by subsidizing the proposed hotline.

V. CONCLUSION

The convergence of troubled fronts—a cooling housing market, increasing adjustments on variable-rate mortgages, and rising home-energy and fuel costs—will soon create a perfect storm, resulting in a surge of foreclosures within the next few years. Although foreclosure scams have been around for some time, more con artists will undoubtedly take advantage of this predicted storm. Trolling through state foreclosure records, fraudulent “rescue” companies find homeowners with sizeable home equities and promise to rescue them from foreclosure. A few states have enacted statutes to protect homeowners by regulating foreclosure consultants and purchasers. These states should amend them to deter practices that amount to phantom help.

276. See J. Michael Collins, *Foreclosure Prevention: Preserving Affordable Homes and Vital Communities*, 8 HOUSING FACTS & FINDINGS 1, 3 (2006), available at http://www.fanniemae.foundation.org/programs/hff/v8i2-foreclosure_prev.shtml.

277. See generally Coppola, *supra* note 275, at 2 (stating that a foreclosure-intervention strategy would prove successful if it recognized research showing a borrower’s willingness to work with “a trusted nonprofit intermediary”).

278. See COLLINS, *supra* note 244, at 2.

279. MARK WIRANOWSKI, JOINT CTR. FOR HOUS. STUDIES, SUSTAINING HOME OWNERSHIP THROUGH EDUCATION AND COUNSELING 31 (2003), http://www.jchs.harvard.edu/publications/homeownership/w03-7_wiranowski.pdf.

280. See COLLINS, *supra* note 244, at 2.

States should also prevent foreclosure companies from devouring a homeowner's equity by limiting their compensation. For example, states could require that foreclosure purchasers pay a homeowner 82 percent of the property's fair market value at the time of closing. This would allow legitimate foreclosure purchasers to make a reasonable profit and would also increase the likelihood that a homeowner could make the required rental payments and ultimately repurchase the home.

States should also consider implementing a 311 mortgage-default hotline to connect homeowners directly to foreclosure-intervention firms that have received satisfactory ratings. Firms would then have an incentive to meet the rating standards. With lenders subsidizing the system's services, foreclosure rates would decrease because homeowners would be able to work through their financial issues with legitimate foreclosure-intervention firms.