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Lenders Prevail in Lawsuits by Borrowers Seeking to Enforce Federal Loan Modification Programs

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The authors discuss the history and regulatory structure of the federal loan modification programs and chronicle the decisions of those courts that have been called upon to confirm that borrowers may not enforce them through civil actions.

Frustrated by depreciating property values and failed attempts to modify their loans, distressed borrowers continue to file lawsuits against their lenders and others as a means of redress. In their search for viable legal theories, plaintiffs and their attorneys have now tried a new breed of claim with its roots in the federal programs designed to encourage loan modifications. While details vary from case to case, borrowers generally assert that their servicers are not abiding by the requirements of federal loan modification programs and related participation agreements. They claim that their servicers are foreclosing without considering their modification eligibility, and are improperly assessing their eligibility for relief.

It is axiomatic that borrowers have no contractual right to modify their loans unilaterally, and none of the recently enacted federal laws designed to encourage loan modifications *require* that any particular loan be modified. While these programs may require lenders to *consider* borrowers

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for modification *eligibility*, and postpone foreclosures while doing so, a growing number of courts have confirmed that borrowers cannot enforce these requirements through civil actions. This article summarizes the history and regulatory structure of the federal loan modification programs and chronicles the decisions of those courts that have been called upon to confirm that borrowers may not enforce them through civil actions.

CONGRESS ACTS TO STEM DEFAULTS AND PRESERVE HOME OWNERSHIP

As the gravity of the credit crisis emerged, Congress passed the Emergency Economic Stabilization Act ("EESA") signed into law in October 2008. Section 101 of the EESA authorized the Secretary of the Treasury to create the Troubled Asset Relief Program, originally designed to purchase troubled assets from financial institutions. Among other provisions, Section 109 of the EESA variously required and permitted the Secretary to take certain measures to encourage and facilitate loan modifications, such as the Home Affordable Modification Program ("HAMP"). Since its creation, many national lenders have signed on by executing HAMP Servicer Participation Agreements.

As defaults and foreclosure rates worsened, Congress passed the Helping Families Save Their Homes Act ("Helping Families Act") signed into law in May 2009. The Helping Families Act ushered in an array of new measures designed to reduce foreclosures, preserve homeownership, and fight the contraction of the real estate market. Congressional findings stated that it would be necessary to grant servicers authorization to enter into loan modifications consistent with the Secretary's guidelines under the EESA, and passage of the Helping Families Act brought about a moratorium on certain foreclosures, "until the foreclosure mitigation provisions … and the President's 'Homeowner Affordability and Stability Plan' have been implemented and determined to be operational …."

To implement the HAMP program, the Secretary issued guidelines requiring servicers to consider borrowers for loan modifications and suspend foreclosures while evaluating them. HAMP also requires mortgagees to collect, retain and transmit mortgagor and property data to ensure compliance with the program. The compliance officer for the program is Freddie Mac, which is charged with conducting "independent compliance assessments," including "evaluation of documented evidence to confirm adherence … to HAMP requirements" such as the evaluation of borrower eligibility.

The Helping Families Act also contains specialized treatment for federal program loans, such as FHA and VA loans. For example, with respect to FHA loans, the Act enabled the Secretary to establish a program that would "encourage loan modifications for eligible delinquent mortgages or mortgages facing imminent default … through the payment of insurance benefits and the assignment of the mortgage to the Secretary and the subsequent modification of the terms of the mortgage according to a loan modification approved by the mortgagee." FHA-HAMP charges the FHA with monitoring compliance.

COURTS CONFIRM BORROWERS CANNOT ENFORCE COMPLIANCE THROUGH CIVIL ACTIONS

Since the creation of these federal programs, borrowers electing to file lawsuits against their lenders and servicers have attempted to use them as a sword. Courts in California and Arizona — two of the hardest hit states in foreclosure rates resulting in a high volume of distressed borrower-fueled litigation — have been called upon to consider whether borrowers may do so. Courts in both states have soundly rejected those efforts.

The recent District of Arizona decision in *Robinson v. Wells Fargo, et al.* contains the most thorough and up-to-date analysis regarding why borrowers cannot enforce compliance with federal loan modification programs through civil actions.[1] There, the plaintiff claimed that his servicer had not considered his eligibility for a HAMP modification despite his requests for one, and was instead proceeding to foreclosure unabated. In determining whether the plaintiff had standing to enforce HAMP, the court applied the four-factor test of *Cort v. Ash* to analyze whether a private right of action existed under federal law:

(1) whether the plaintiff is "one of the class for whose especial benefit the statute was enacted — that is, [whether] the statute create[s] a federal

right in favor of the plaintiff;"

(2) whether "there [is] any indication of legislative intent, explicit or implicit, either to create such a remedy or to deny one;"

(3) whether the cause of action is "consistent with the underlying purposes of the legislative scheme;" and

(4) whether "the cause of action [is] one traditionally relegated to state law, in an area basically the concern of the States, so that it would be inappropriate to infer a cause of action based solely on federal law."

Applying these factors, the *Robinson* court reasoned that no private right of action existed.

As a preliminary matter, the text of the EESA and the Helping Families Act does not expressly provide for any private right of action against lenders. These statutes focus on the parties regulated and the agencies tasked with overseeing the regulations, rather than the individuals protected, and "[s]tatutes that focus on the person regulated rather than the individual protected create 'no implication of an intent to confer rights on a particular class of persons.'" Put another way, the economic stimulus effort promotes the welfare of foreclosure parties generally and the economy as a whole, but it does not connote the power to delay foreclosures through litigation. Indeed, the EESA's savings clause preserves pre-existing mortgage rights notwithstanding the Secretary's actions.[2]

The *Robinson* court went on to note that Congress has demonstrated through its TARP legislation the ability to create a private right of action when it wants to do so. Both the EESA and the Helping Families Act expressly provide for other specific rights of action. One such right lies against the Secretary via the Administrative Procedure Act, and even there the EESA limits the scope of review and available remedies. The other relates to certain new disclosure requirements under the Truth-in-Lending Act. Thus, "it is highly unlikely that 'Congress absent mindedly forgot to mention an intended private action' against TARP fund recipients." In fact, the court noted, "[b]y providing a cause of action against the Secretary, but not mentioning a cause of action against non-governmental entities, Congress demonstrated its intent to limit private action under TARP solely to actions against the Secretary and not to extend any obligations or liabilities to those receiving TARP funds." Though the *Robinson* court did not address the issue, the parallel conclusion that no right of action exists under other HAMP programs — such as FHA-HAMP — accords with case law before and after the passage of the EESA. In years prior to the EESA, "efforts to enforce implied causes of action under the National Housing Legislation or the HUD Handbook … frequently [came] under consideration of appellate courts, and [had] always failed," whether the defendant was private or public.[3]

Because the court in *Robinson* held that Congress did not intend to create a private right of action, considering the final two *Cort* factors was unnecessary, but neither of the remaining factors would support the existence of a claim in any event. The borrower-plaintiffs' proposed cause of action would not further the underlying legislative scheme because the objective of the Helping Families Act was not to redress perceived wrongdoing at the option of individual borrowers, but to stem further damage to the economy as a whole. The Guidelines bear out this view, appointing Freddie Mac as compliance officer and imposing extensive data reporting requirements to it. Enforcement of the modification program is contemplated only from the top down. As to the fourth *Cort* factor, foreclosure proceedings, their nature and timing are generally a state law concern.

COURTS ALSO CONFIRM THAT BORROWERS CANNOT ENFORCE THIRD-PARTY PARTICIPATION AGREEMENTS

Aggrieved borrowers have attempted to make an end-run around this analysis by asserting breach of contract claims too. They claim that their lenders and servicers have breached their participation agreements with the federal government. For example, the Financial Instrument accompanying Servicer Participation Agreements provides that "all mortgage modifications and all trial period modifications will be offered to borrowers, fully documented and serviced in accordance with" Treasury directives. But courts have held that borrowers cannot enforce these agreements because they are not parties to them and they lack the right to do so as third-party beneficiaries.

As a preliminary matter, the HAMP agreements state that they are "governed by and must be construed under federal law." Under federal law, "[p]arties that benefit from a government contract are generally *assumed* to be incidental beneficiaries, and may not enforce the contract absent a clear intent to the contrary."[4] This result makes perfect sense. Otherwise, any private citizen could bring suit over virtually every government contract in existence because, by their nature, government contracts incidentally benefit American citizens.

In *Escobedo v. Countrywide Home Loans, Inc.*, a California court called upon to resolve whether borrowers can maintain a breach of contract claim against their lenders as third-party beneficiaries to a participation agreement noted that, "[t]he language of the [HAMP] contract does not show that the parties intended to grant qualified borrowers the right to enforce the Agreement."[5] Rather, the HAMP agreement states that it "shall inure to the benefit of … the parties to the Agreement and their permitted successors-in-interest." Thus, "[a] qualified borrower would not be reasonable in relying on the Agreement as manifesting an intention to confer a right on him or her because the Agreement does not require that [the lender] modify eligible loans." Borrowers are therefore incidental beneficiaries lacking any enforceable rights under the HAMP Agreement.[6]

Some plaintiffs argue that courts are split on this issue, citing the earlier decision in *Reyes v. Saxon Mortgage Services*, and arguing that it undermines *Escobedo*.[7] *Reyes*, however, is no longer valid, disavowed even by its author. The fact that *Reyes* fails to cite a single case or federal statute with respect to the HAMP Agreements bears this out. Even more telling, the author of the *Reyes* decision, Judge Sabraw, has now reversed herself and adopted *Escobedo*'s third-party beneficiary analysis of the HAMP Agreements.[8] As a result, *Escobedo* marks a steady trend of cases that reject borrowers' attempts to enforce the HAMP Agreements as third party beneficiaries.[9] While attorneys representing borrowers in litigation against their lenders and servicers will no doubt continue in their search for viable claims as long as default rates remain high, this new breed of HAMP enforcement claim seems ready for early retirement.

NOTES

[1] *See* No. 09-2066-PHX-JAT, 2010 WL 2534192 (D. Ariz. June 18, 2010).
[2] 12 U.S.C. § 5229(b)(1)-(2).
[3] *See, e.g., Burroughs v. Hills*, 741 F.2d 1525, 1532 (7th Cir. 1984).
[4] *Escobedo v. Countrywide Home Loans, Inc.*, No. 09-CV-1557, 2009 WL 4981618, at *2 (S.D. Cal. Dec. 15, 2009).
[5] *See, e.g., Escobedo*, 2009 WL 4981618, at *2.
[6] *Id.*
[7] *See* 2009 WL 3738177 (S.D. Cal. Nov. 5, 2009).
[8] *See Villa v. Wells Fargo*, No. 10-CV-81, 2010 WL 935680, at *3 (S.D. Cal. Mar. 15, 2010) ("This Court finds *Escobedo* persuasive and adopts its reasoning.").
[9] *See, e.g.*, *Aleem v. Bank of America*, No. 09-0182, 2010 WL 532330, at *4 (C.D. Cal. Feb. 9, 2010) (rejecting allegations "that Defendants violated their Participation Agreement under [HAMP] by refusing to determine Plaintiffs' eligibility for loan modification" because "[t]here is no express or implied right to sue fund recipients … under TARP or HAMP"); *Villa*, 2010 WL 935680, at *3; *Williams v. Geithner*, Civ. No. 09-1959, 2009 WL 3757380 (D. Minn. 2009).