MEMORANDUM

TO: Drafting Committee Members, Advisors and Observers,
Proposed Home Foreclosure Procedures Act
FROM: Bill Breetz, Chair of the Drafting Committee
DATE: May 12, 2014

RE: May 16 - 17, 2014 Drafting Committee meeting
St. Gregory Hotel
2033 M St. NW
Washington, DC 20036

I. INTRODUCTION

Last week, the Chicago office distributed both a redlined and clean draft of the Home Foreclosure Procedures Act for consideration at the May meeting in Washington DC. As has been our invariable practice, the draft represents the work of our Co-Reporters James Charles Smith and Alan White, and several conference calls between the co-Reporters, American Bar Association Advisor Barry Nekritz and me. The draft also incorporates the efforts of two working groups, one that reviewed Article 3 (Facilitation) and a second that met twice to consider the Holder In Due Course provisions of Section 606. The draft itself contains introductory thoughts on both those subjects, which can be found preceding the relevant sections of the Act.

As usual, we will convene on Friday morning, May 1 at 9 am and conclude for the day at 5 pm. We will follow the same schedule on Saturday. I have not scheduled a Sunday meeting, as we did in San Diego. An agenda for the meeting is attached as **Exhibit A** to this memorandum.

You will again find a considerable number of redlined amendments in the draft, as compared to the January 2014 draft considered in San Diego; most of those changes were proposed in San Diego. In particular, please review these entirely new sections before the meeting so that we may have a full discussion of them.

SECTION 107. SERVICERS.
SECTION 108. NO WAIVER.
SECTION 109. KNOWLEDGE AND NOTICES.
SECTION 110. SUPPLEMENTAL PRINCIPLES OF LAW.

As always, substantial policy differences remain in the draft, and I touch on those issues below where some of you have sent me comments. However, because several major policy issues were resolved in San Diego, I have not felt in necessary to prepare a separate “Issues Memorandum”.

II. COMMENTS AND MATERIALS REGARDING SUBSTANTIVE ISSUES

A. SERVICER'S DUTY OF CARE Tom Cox has forwarded a May 7 decision of the Montana Supreme Court. In ***Morrow v. Bank of America,* 2014 MT 117**, the Court held that the Plaintiff borrowers, who were in foreclosure, had alleged facts which, if true, stated viable claims against their mortgage servicer for negligence, negligent misrepresentation, actual fraud, constructive fraud, and violations of the Montana Unfair Trade Practices Act. The Montana Judicial Department's synopsis of the case is attached as **Exhibit B** to this memorandum.

B. LENDER REACTION TO SECTION 106 (Application of Local Regulations)

This topic remains one of the Act's more controversial provisions. Your Chair has made three presentations on the Act since our January meeting: at a seminar presented at the New England School of Law in Boston MA, to ACREL in Hawaii and at a CLE seminar presented by the Bar of the City of New York. In all three presentations, lender representatives pointed to municipal involvement in the foreclosure process as a very serious issue and expressed strong support for the version of Section 106 which the Committee rejected in San Diego. Matthew Street of the American Bankers Association confirms that lender reaction to the amendments to this Section in San Diego, which appear in this Draft, has been uniformly negative. I attach as **Exhibit C** a letter sent earlier this month from Louise Rynd, General Counsel to the Pennsylvania Bankers' Association. In concluding her letter, Attorney Rynd writes:

> We understand your Drafting Committee is considering alternative proposals on intrastate preemption of political subdivision actions regarding mortgage lending. Upon the recommendation of PBA's Legal Affairs Advisory Committee, our Government Relations Policy Committee prefers the version excerpted below:
>
> **SEC 106. APPLICATION OF LOCAL REGULATIONS.**
>
> (a) [Notwithstanding (insert reference to any applicable 'Home Rule' provisions under the law of this state)] No ordinance or regulation of a municipality, county or other political subdivision in this state may (i) regulate, restrict or limit the process by which mortgages on residential property are foreclosed, or (ii) impose any obligation on a person holding an interest in a mortgage or deed of trust on residential property which is not imposed on all owners of real property in that political subdivision, unless expressly authorized by legislation of this state.]
>
> (b) Except as otherwise provided in subsection (a), the provisions of this [act] do not invalidate or modify any provision of any zoning, subdivision, building or safety code, or any other ordinance or regulation generally applicable to the use of real estate.

C. ADDITIONAL THOUGHTS ON HOLDER IN DUE COURSE On May 1, 2014, Mark Greenlee of the Cleveland Federal Reserve Bank sent me an email on this subject; it is attached as **Exhibit D.** In summary, he wrote:

1. I don't think that preserving claims that "could reasonably have been discovered in the exercise of due diligence" is helpful to homeowners. They are not going to use this basis because they lack knowledge of due diligence practices by the acquirers of obligations. So, it's an illusory basis for preservation of claims. That said, I don't think it's harmful to homeowners so long as it's an alternative basis for the preservation of claims.***

2. I think that numbers should be inserted for the Xs in subsection (c).*** I would find 4 years acceptable.

3. I think that a shorter time limit after interest rate adjustment is acceptable***.I'm suggesting 2 years.

4. I think that a slight change in language is needed to avoid the use of nominal interest rate adjustments to game the system****I'm not sure what percentage change should start the 2 year period, but I'm suggesting 1 percent.

He concludes: "I hope that the drafting committee will take a yea-or-nay-vote on some language limiting HDC for inclusion in the draft to present to the commissioners at the 2014 annual meeting.:

D. MATERIALS ON FACILITATION Commissioner Kent has forwarded a newsletter prepared by Resolution Systems Institute, a Chicago group known to the Drafting Committee as the former employer of Heather Scheiwe Kulp (now at Harvard and a recent mother). Several brief articles discuss matters related to facilitation. The newsletter is attached as **Exhibit E**.

III. OTHER MATTERS

I note that at least three members of the Drafting Committee will be unable to join us. ***Martha Walters** will be traveling in Japan; ***Carl Lisman** will be traveling in Peru; and ***Bruce Coggeshall** has a long scheduled and unavoidable conflicting meeting. Finally, ***Melissa Hortman** is still engaged in the end of session shenanigans (my word, not hers) of the Minnesota Legislature, and may not be able to join us.

Some observers who have been active in earlier drafting meetings will also not be able to attend this meeting. It is apparently cost prohibitive for the ULC to offer absent observers or Committee members the opportunity to participate on a telephone hook-up or view the meeting on Skype. However, we would very much welcome your written comments, which the Reporters and I will endeavor to incorporate into the discussion at the appropriate time.

HOME FORECLOSURE PROCEDURES ACT DRAFTING COMMITTEE MEETING

FRIDAY, MAY 16 and SATURDAY, MAY 17, 2014

REVISED AGENDA

Friday, May 16, 2014

9:00 – 9:15 am	Welcome and Introductions
9:15 – 12:00 pm	Consideration of UCC-related matters: o Article 4 – Who can enforce o Section 606 – Holder in Due Course o Section 104 – Good Faith and Commercial Reasonableness
12:00 – 1:15 pm	Lunch break [on own]
1:15 – 1:30 pm:	Remarks of Stephanie Heller concerning the proposed Electronic Note Registry
1:30 – 2:00 pm	Section 203 (Right to Cure Default) Neil Cohen observes: "[T]here should be a clear answer to whether this section is intended to allow debtors to cure defaults on the mortgage note only in the context of foreclosure on the mortgage or also in situations in which the creditor seeks to get a judgment on the note without, at the same time, foreclosing on the mortgage.)"
2:00 – 3:30 pm	Consideration of Article 3 (Facilitation) and model rules
3:30 – 4:00 pm	Consideration of Section 106 (Application of Local Regulations)
4:00 – 5:00 pm	Consideration of Abandoned Property (Sections 505through 507) *See Mark Greenlee letter of May 13, 2014*

Saturday, May 17, 2014

9:00 – 10:00 am	Consideration of New Sections 107 through 110
10:00 am – 12:00 pm	Line-by-Line Consideration of the remaining sections of the Act
12:00 – 1:15 pm	Lunch break [on own]
1:15 – 5:00 pm	Further Consideration of the Act

SYNOPSIS OF THE CASE

2014 MT 117, DA 13-0241: ABRAHAM B. MORROW and BETTY JEAN MORROW, Plaintiffs and Appellants, v. **BANK OF AMERICA, N.A., BAC HOME LOANS SERVICING, LP, fka COUNTRYWIDE HOMELOANS SERVICING, LP,** Defendants and Appellees.[1]

The Montana Supreme Court allowed homeowners Abraham B. and Betty Jean Morrow to proceed with their lawsuit against their mortgage servicer, Bank of America. The Morrows claim Bank of America promised them over the phone that it would reduce the payments on their mortgage under the federal Home Affordable Modification Program (HAMP). The Morrows say the Bank promised to reduce their interest rate and extend the term of their loan from 15 years to 40 years. The Morrows say they made the lowered payments for over a year, only to have Bank of America reject their application for a modification and begin foreclosing on their home. Bank of America denies promising the Morrows a modification, and says they were ineligible for the program because the home was not their primary residence.

The Morrows obtained an injunction stopping the foreclosure and sued Bank of America for breach of contract, fraud, negligence, negligent misrepresentation, and violations of the Montana Consumer Protection Act (MCPA). The Lewis and Clark County District Court granted summary judgment to Bank of America. The District Court said the Morrows could not legally enforce an oral agreement to modify their loan, because it had to be in writing. The District Court also said the Morrows could not use fraud and consumer protection claims as an attempt to enforce the oral agreement. Finally, the District Court said the Bank was not negligent, because it was not the Morrows' financial adviser and owed them no legal duty.

The Supreme Court affirmed the District Court's decision on the breach of contract claim. The Morrows' loan documents were written agreements and could only be modified in writing or by proof that the oral agreement had already been fully performed. The oral agreement also would have extended the deed of trust that secured the loan for an additional 25 years. An extension of a deed of trust must be made in writing and placed in the county land records.

The Supreme Court reversed summary judgment on the Morrows' negligence claim. The Supreme Court held that, assuming the facts alleged by the Morrows to be

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[1] This synopsis has been prepared for the convenience of the reader. It constitutes no part of the Opinion of the Court and may not be cited as precedent.

true, Bank of America owed a fiduciary duty to the Morrows because it had actively advised them during the modification process. Bank of America was not required to modify the Morrows' loan, but once it accepted their application, it had a duty to process the application promptly and give them accurate information. Because it told the Morrows their application would be processed under HAMP, the Bank also had a duty to follow federal guidelines. The Morrows' allegations raised questions as to whether Bank of America had fulfilled those duties that should be resolved at a trial.

The Supreme Court also reversed summary judgment on the Morrows' claims of fraud, constructive fraud, and negligent misrepresentation. The Supreme Court held that although an oral agreement may be unenforceable as a contract, the statements can still be used as evidence for other purposes. The Court held that the rule requiring written contracts in certain cases, called the Statute of Frauds, exists to prevent fraud and should not be used as a defense by those who have allegedly committed fraud. The Morrows allege Bank of America committed fraud by telling them to intentionally miss a payment to be considered for a modification. They claim the Bank told them they had been approved for a modification when they had not, and that they should ignore notices of default.

Finally, the Supreme Court reversed summary judgment on the Morrows' MCPA claim. The Morrows claim the Bank gave them conflicting information about the status of their loan and the amount they were required to pay. The Morrows claim the Bank instructed them to make reduced payments without telling them that doing so would make them delinquent on their mortgage. The Bank took ten months to reach a decision on the Morrows' application for a modification, instead of the three months standard under HAMP. The Supreme Court held that these allegations, if proven to be true, represent practices substantially injurious to Montana consumers.

The Morrows' claims of negligence, negligent misrepresentation, actual and constructive fraud, and violations of the MCPA will now be returned to the District Court for further proceedings.

Justice McKinnon, in a separate opinion joined by Justice Rice, partially concurred and dissented from the Supreme Court's decision. The two Justices concurred with the Supreme Court's conclusions that summary judgment in favor of the Bank was proper on the Morrows' contract claims, and that summary judgment was improper on the Morrows' negligence, negligent misrepresentation, and MCPA claims. They dissented, however, from the Supreme Court's conclusion that the Morrows have alleged facts which would support a claim of constructive fraud. The dissenting Justices

maintain that the Supreme Court has not heretofore recognized a common law claim of constructive fraud and that the statutory basis for constructive fraud, upon which the Supreme Court relies in approving the Morrows' constructive fraud claim, has been neither pleaded nor argued by the parties. Moreover, to the extent a claim of constructive fraud could be maintained by the Morrows, it would require a showing that the Bank gained an unfair advantage from its allegedly false statements—an allegation which also has been neither pleaded nor argued by the Morrows.

Finally, although Justices McKinnon and Rice agree that the Morrows may pursue a claim of actual fraud, such a claim requires a showing of "intent to deceive." Since the Bank cannot be found to have made the allegedly false statements both intentionally and negligently, either the claim of actual fraud or the claim of negligent misrepresentation must fail upon a trier of fact's finding of the Bank's intent. The partial concurrence and dissent additionally addressed the procedures for determining on remand whether the facts support a finding of a fiduciary duty owed by the Bank to the Morrows on their negligence claim.

EXHIBIT C- LETTER FROM PENNSYLVANIA BANKERS ASSN

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May 5, 2014

William Breetz, Chairman

Uniform Law Commission Drafting Committee on a Home Foreclosure Procedures Act
Connecticut Urban Legal Initiative, Inc.
University of Connecticut School of Law
35 Elizabeth St, Hartford, CT 06105
Via: william.breetz@law.uconn.edu

Re: Draft Home Foreclosure Procedures Act: Section 106

Dear Chairman Breetz:

Thank you for your and your Committee's work to date on the Home Foreclosure Procedures Act. The Pennsylvania Bankers Association (PBA) realizes that this project is a significant undertaking and appreciates the fact that your Committee has welcomed input from the banking industry.

The American Bankers Association recently notified the PBA of your interest in receiving comments on the specific issue of state preemption of political subdivision regulation of mortgage foreclosure. PBA is pleased to share its view about this important issue.

It should be noted that local government in Pennsylvania has been described as a "mosaic." According to a publication by our Local Government Commission, as of January 2003, there were 67 counties, 56 cities, 961 boroughs, one incorporated town, 1,548 townships

(91 first class; 1,457 second class), 501 school districts and 2,015 authorities. Given the number of political subdivisions in this Commonwealth, it is essential to reserve the enforcement of laws relating or incidental to

banking for the federal and state governments. In recognition of that essential need, Pennsylvania enacted Section 6152 of the PA Banking Code & Section 506 of the PA DoBS Code, which limit the powers of political subdivisions relative to banks' financial or lending activities.

We understand your Drafting Committee is considering alternative proposals on intrastate preemption of political subdivision actions regarding mortgage lending. Upon the recommendation of PBA's Legal Affairs Advisory Committee, our Government Relations Policy Committee prefers the version excerpted below:

SECTION 106. APPLICATION OF LOCAL REGULATIONS.

(a) [Notwithstanding (insert reference to any applicable 'Home Rule' provisions under the law of this state)] No ordinance or regulation of a municipality, county or other political subdivision in this state may (i) regulate, restrict or limit the process by which mortgages on residential property are foreclosed, or (ii) impose any obligation on a person holding an interest in a mortgage or deed of trust on residential property which is not imposed on all owners of real property in that political subdivision, unless expressly authorized by legislation of this state.]

(b) Except as otherwise provided in subsection (a), the provisions of this [act] do not invalidate or modify any provision of any zoning, subdivision, building or safety code, or any other ordinance or regulation generally applicable to the use of real estate.

Again, PBA appreciates your interest in our view and stands ready to discuss it with you/your colleagues should any questions arise.

Sincerely,

Louise A. Rapp

EXHIBIT D – COMMENTS OF MARK GREENLEE

Bill,

A few comments on Section 606 of the Second Preliminary Draft dated March 24, 2014 –

1. I don't think that preserving claims that "could reasonably have been discovered in the exercise of due diligence" is helpful to homeowners. They are not going to use this basis because they lack knowledge of due diligence practices by the acquirers of obligations. So, it's an illusory basis for preservation of claims. That said, I don't think it's harmful to homeowners so long as it's an alternative basis for the preservation of claims. I think that this is the case because of the "or" in the list of bases in subsection (b). To clarify this, I suggest changing the "and" to an "or" in the Reporters' Note 2.

2. I think that numbers should be inserted for the Xs in subsection (c). Initially, I argued in favor of 7 years as a time limit for the assertion of claims and defenses because it approximates the average life of a residential mortgage loan. Some members of the drafting committee and HDC work group proposed 1 year. At the March 20th meeting of the HDC work group, one member tried to garner support for 4 years without success. I would find 4 years acceptable. It is a time period similar to the longevity of obligations securitized in the consumer goods and services market where the FTC Holder Rule preserves claims and defenses.

3. I think that a shorter time limit after interest rate adjustment is acceptable. I'm looking for a time period that would allow homeowners to discover and react to interest rate adjustments, as well as time for homeowners to realize that deferring the payment of other obligations to make mortgage payments is no longer realistic (e.g., not paying for medication or not paying credit card bills to make mortgage payments). I'm suggesting 2 years.

4. I think that a slight change in language is needed to avoid the use of nominal interest rate adjustments to game the system. As currently drafted, a 1/10 of a percentage interest rate adjustment 6 months after origination of a loan would start the 2 year time period. I'm not sure what percentage change should start the 2 year period, but I'm suggesting 1 percent.

5. I also suggest changing the phrase "imposes a clear statute of limitation" in Reporters' Note 2 to "imposes a clear time limitation on the assertion of claims and defenses."

A redlined version of section 606 and the Reporters' Notes reflecting my comments is attached.

Now, I may or may not make another proposal. I like the approach taken in the Second Preliminary Draft because it applies to all "mortgaged property" as defined by section 102(14) of the Act. One rule that applies to all mortgaged property appeals to me from a simplicity/efficiency perspective. It avoids lots of legal and compliance costs. However, the primary reason for limiting HDC is to correct misbehavior in the subprime mortgage market. This is where almost all of the fraud and misrepresentations occurred in the recent crisis.

So, I have been thinking about an idea discussed at the March 20th meeting of the HDC working group – preserving claims and defenses for the group of non-qualified mortgages as defined by the Ability-to-Repay Rule issued by the Consumer Financial Protection Bureau. The question I am struggling with is whether non-qualified mortgages sufficiently cover subprime mortgage loans. I may send you language before the May 16th meeting of the drafting committee proposing that the limitation on HDC apply only to non-qualified mortgages.

In any event, I hope that the drafting committee will take a yea-or-nay-vote on some language limiting HDC for inclusion in the draft to present to the commissioners at the 2014 annual meeting.

See you in DC on May 16th.

Mark

EXHIBIT E

May 2014

In this issue, you'll find...

Court ADR News

New Research

From Just Court ADR Blog

Court ADR News

Grant Helps New Alabama Mediators to Bridge Divide between Homeowners and Lenders

In April, the Alabama Center for Dispute Resolution trained nearly forty new mediators in foreclosure mediation and mortgage modification. The training was made possible by a $500,000 grant the center received through Attorney General Luther Strange's office last year. Judith Keegan, the center's director, says that mediators are an important bridge for communication between homeowners and lenders. Neither party is charged a fee for the mediation process; instead it is paid for by the Attorney General's grant. The program will run until April 30, 2015.

With Housing Crisis Still Raging, Maine Improves Foreclosure Mediation Process

The state of Maine has enacted a new law to improve the foreclosure process in the state. The law is the result of a six-month long examination of the home foreclosure process conducted by the Maine Attorney General. The results showed that the housing crisis was still affecting Maine, with hundreds more foreclosures in 2013 than in 2012. The Attorney General also concluded that the state's foreclosure mediation process, which began in 2009, was successful overall. However, adjustments were made to make the process more efficient and more responsive to homeowners. The resulting bill, L.D. 1389, received unanimous approval from the Judiciary Committee and was signed into law in mid-April. Some of the goals of the legislation are designed to strengthen the role of mediation by ensuring mediators are trained in principal loss mitigation guidelines and regulations from a list of government agencies, and seeking increased funding for housing counselors.

International Online Dispute Resolution Conference Slated for June 25-27

The 2014 International Online Dispute Resolution Conference will take place June 25-27 at locations in Silicon Valley and San Francisco, including UC Hastings College of Law and Stanford Law School. The conference will include topics such as solving consumer problems, privacy, and using ODR in the courts. As a preliminary event, a "Tech for Justice Hackathon" will take place on June 21-22.

New Research

Foreclosure Mediation Program Settles Cases, Addresses Delays

Maine's Foreclosure Diversion Program has submitted its annual report for 2013, providing insight into the mediation program's outcomes. Approximately 36% of foreclosures filed in 2013 entered the program, down from 43% in 2012. Of those cases mediated in 2013, 21% have been dismissed so far, while 13% have ended in foreclosure. Another 28% are still working their way through the program, while 38% have been returned to the docket. Data from 2010 shows that 60% of cases that entered mediation led to dismissal and 36% resulted in foreclosure in 2010. In 2011, these numbers remained stable, with 59% being dismissed, while 35% ended in foreclosure.

Data for type of disposition is only available for 32% of cases mediated between 2010 and 2013. Of those, 67% of homeowners received a loan modification. Another 5% received reinstatement, while 4% ended with a repayment or forbearance plan. In 8% of known dispositions, the homeowner and lender agreed to a short sale and 4% agreed to a deed in lieu of foreclosure.

The annual report also discusses a pilot project that was launched in 2012. The Administrative Office of the Courts launched the project to address delays caused by issues with the exchange of documents between the homeowner and the lender. In the standard process, homeowners attend an informational session, then have 21 days to send all necessary documentation to the lender. The lender then has 21 days to review the documents before mediation. Homeowners have had difficulty figuring out what they needed to provide, while lenders have often changed what they want the

homeowner to provide between the informational session and the mediation. This means that the first mediation session is being spent determining how to assemble the homeowner's required documents.

In response, the pilot project addresses this problem by having the informational session and first mediation session take place on the same day. The 30-45 minute mediation makes a plan for document submission and loan review. In the three pilot courts, the average number of days the pilot group spent in the program was between 18% and 55% lower than for the control group.

From Just Court ADR Blog

Property and Financial ADR Options for Families Will Expand Thanks to Cook County Rule Change

"The Circuit Court of Cook County Illinois serves more than 5 million residents of Chicago and surrounding suburbs. The recent revision of the county's rule on domestic relations mediation, Cook County Circuit Court Rule 13.4(e), builds on the court's long-standing program of mediation services required and provided by the court. Previously, the rule covered all contested initial determinations of custody, visitation, or parenting time, changes to those issues, and removal or relocation of the child. The revised rule leaves that program in place, while adding new options for the courts and families." Read the rest of this post by Bonnie Peters >>

Foreclosure Mediation Programs Reflect and Refine

"Foreclosure mediation programs can now be found all over the country. Models vary widely, both in their rules and procedures and in terms of the populations they serve. Most programs were started as a response to the mortgage foreclosure crisis and some programs have been around for a number of years now. While it's often argued that the worst of the housing crisis is behind us and that foreclosure mediation programs are no longer necessary, new studies are revealing that the need is there, that programs can be effective, and that there are lessons to be learned in terms of how programs can maximize results." Read the rest of this post by Shawn Davis >

More Evidence of the Effectiveness of Restorative Justice

"For this month's Court ADR Connection (RSI's monthly e-newsletter), I wrote about a study of 10 restorative justice conferences that demonstrated significant benefits to the community by reducing re-offense and to victims by enhancing their emotional well-being. New research from New Zealand provides more evidence of the benefits of RJCs." Read the rest of this post by Jennifer Shack >>