

Lawyers and Rescue Scams

Partnering with Loan Modification Companies May Present Ethical Implications

By Rutledge Simmons

NeighborWorks America (“NeighborWorks”) seeks to prevent community decline that results from a concentration of foreclosed and vacant properties. Undermining its foreclosure prevention efforts are mortgage rescue scams. In short, a mortgage rescue scam occurs when a distressed homeowner pays a service provider an upfront fee to save a home from foreclosure and the service provider does little or nothing for the fee. Unfortunately, an increasing percentage of these scammers are lawyers who do the scamming or who affiliate for a fee with those doing the scamming. Let’s review the events contributing to the increase in lawyer involvement in rescue scams and the efforts nonprofits, regulators, attorneys general, bar associations and legislators are undertaking to reverse the trend.

Foreclosure Prevention Efforts are Enhanced

In 2005 NeighborWorks undertook steps to address a potential foreclosure crisis on the horizon. With the support of Governor Ned Gramlich, then a Federal Reserve Board Governor and NeighborWorks Board Chairman, NeighborWorks established the Center for Foreclosure Solutions (the “Center”). The Center trains nonprofit housing counselors to conduct foreclosure prevention counseling. These nonprofit counselors help distressed homeowners navigate the foreclosure process and facilitate loan modifications when viable.

Resources for NeighborWorks’ strategy were enhanced considerably when Congress established and funded the National Foreclosure Mitigation Counseling Program (the “Program”). NeighborWorks was asked to develop and administer the Program. As a result, NeighborWorks has trained many more counselors and helped fund counseling services on a scale that was not previously possible at the Center. Hundreds of nonprofit counseling agencies and thousands of counselors

have received funding under the Program, and they in turn have advised over a million homeowners free of charge on their options when facing foreclosure.

Interested Parties Collaborate to Thwart Rescue Scams

The Program's network of counselors is invaluable because they get a ground level understanding of (i) the shortcomings of any foreclosure prevention efforts and (ii) the latest incarnation of the rescue scams, which are forever changing, as a way to counter law enforcement initiatives and public awareness campaigns. The Program's counselors share with one another what they have learned via a listserv provided by NeighborWorks. The counselors convey a common story, which consists of homeowners paying thousands of dollars in upfront fees to loan modification companies and getting little or no service for their payment.

Upon learning about the prevalence of the problem, NeighborWorks investigated ways to work with state and federal regulatory agencies, nonprofits, banks and servicers, state attorneys general and other law enforcement entities to coordinate tactics to combat the emerging rescue scam problem. It also convened regular calls with the aforementioned parties to (i) share what it had learned about rescue scams from the Program's networks of counselors and (ii) facilitate information sharing amongst all parties.

It used a multi-million dollar Congressional appropriation to develop a public awareness campaign (the "Campaign") encouraging troubled homeowners to seek free assistance from a list of nonprofit counselors provided by the United States Department of Housing and Urban Development ("HUD"). The Campaign elicited the support of state and federal bank regulatory and law enforcement agencies, state attorneys general, Fannie Mae, Freddie Mac, and national and local nonprofits.

NeighborWorks joined with many of the parties identified above in a coalition called The Loan Modification Scam Prevention Network (the "Network"), which the Lawyers' Committee for Civil Rights under Law (the "Lawyers' Committee") established to both educate homeowners about scams and increase

law enforcement actions against scammers. During periodic meetings of the Network's Steering Committee, it became evident that lawyers were increasingly part of the problem and not the solution.

Lawyers are Increasingly Involved in Scam Activity

The Lawyers' Committee has established an intake system for collecting consumer complaints about mortgage rescue scams and assembling those complaints into a database, which is accessible by members of the Network, including law enforcement. In recent discussions with the database administrator, I learned that of the approximately 10,000 complaints collected to date, more than a quarter involved legal representations as part of the scam. "Legal representation" may entail an attorney being involved directly in the scam, an attorney affiliating with the scammer or the scammer promising to provide legal representation as part of the scam.

Why are lawyers becoming increasingly involved in this type of activity? Well, some states have passed laws barring loan modification companies and their foreclosure counselors from accepting upfront fees for the provision of their services. However, lawyers are often exempted from this prohibition and can accept retainers for legal services.

So, scammers have two options. They can accept fees in violation of the law and many do accept upfront fees because they know that law enforcement often has limited resources to enforce the law. Or they can partner with lawyers as a pretense for getting around the restriction on upfront fees. Thus, lawyers, whether knowingly or unknowingly, have offered these scammers an end run around the restriction on upfront fees. However, these arrangements are fraught with ethical implications for the lawyers, at a minimum.

The growing involvement of lawyers in scams has come to the attention of the American Bar Association (the "ABA"), which recently joined the Network's Steering Committee and has offered to help educate the various state bar associations throughout the country about the problem. The ABA's involvement

will help spread the word that lawyers engaged in business arrangements with loan modification companies are subjecting themselves to potential discipline.

In addition to ethics alerts offered by some state bar associations, some state legislatures are taking targeted actions to address the issue. The state of California passed a law barring lawyers from accepting retainers for loan modification work and requiring them to advise homeowners that the homeowners could accomplish loan modification themselves without professional assistance. Violation of the law could result in a maximum punishment of a \$10,000 fine and a year in jail.

Although the rule does not target lawyers specifically, it is worthy of note that the Federal Trade Commission (the "FTC") passed a law that went in to effect on December 29, 2010, which requires loan modification companies to disclose to consumers, among other things, that they are not associated with the government and that the lender may not agree to modify the consumer's loan. Additionally, as of January 31, 2010 it became illegal to accept upfront fees for loan modification services. Lawyers that affiliate with outfits in non-compliance with the new FTC rule are engaged in a suspect business.

Conclusion

Rescue scamming is a serious problem and over time more and more state bar associations will play a prominent role in educating lawyers about the ethical implications of entering into business arrangements with loan modification companies that scam distressed homeowners. Lawyer participation, actual or perceived, in rescue scam activity will wane and it will become apparent that there are countless lawyers who want to be part of the solution for minimizing rescue scams. To start, I would recommend that lawyers refer distressed homeowners to HUD's website where the homeowner can secure the services of a local, HUD- approved nonprofit foreclosure prevention counselor for free.

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