The Finger in the Dike: State and Local Laws Combat the Foreclosure Tide

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I. INTRODUCTION

The foreclosure crisis that began in 2007 has forced state and local governments to develop a first response capacity to meet a national crisis. States seeking to control foreclosures have always faced certain limitations in enacting laws that limit or impair contract rights. These limits arise primarily under the Contracts Clause of the United States Constitution. Other provisions of the U.S. Constitution, such as the Takings Clause, as well as terms of state constitutions may set additional limits. This article will examine the degree to which various constitutional provisions may limit the ability of states to control mortgage foreclosures. Overall, my conclusion is that under their police power, states have broad authority to limit enforcement of mortgage obligations. This article will trace the history of state laws that have sought to alleviate the harsh effect of foreclosures in the past, beginning with the significant controversies that arose over state foreclosure laws during the Great Depression of the 1930s. Later sections will review trends in recent state legislation. During the current crisis, state and local efforts have focused on foreclosure mediation and conference laws, as well as laws to control servicer conduct, so as to encourage a full consideration of loss mitigation options. Overall, I conclude that recent state laws enacted in response to the foreclosure crisis have been relatively mild and have not approached the true limits of states' authority to control mortgage foreclosures.

II. DEPRESSION-ERA FORECLOSURE LEGISLATION BY THE STATES—BACKGROUND

During a period of eighteen months in 1933 and 1934, twenty-seven states enacted statutes designed to mitigate the effects of the mortgage foreclosure epidemic that was sweeping the country.[1] In February and March of 1933,

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1. *See generally* 2 GARRARD B. GLENN, MORTGAGES, DEEDS OF TRUST, AND OTHER SECURITY DEVICES AS TO LAND §§ 150-167 (1943); GEORGE E. OSBORNE, HANDBOOK ON THE LAW OF MORTGAGES § 331 (2d ed. 1970); RICHARD R. POWELL & PATRICK J. ROHAN, POWELL ON REAL PROPERTY, ¶¶ 441-475 (1968); A.H. Feller, *Moratory Legislation: A Comparative Study*, 46 HARV. L. REV. 1061 (1933); J. Douglass Poteat, *State*

Iowa and Minnesota passed the first such laws shortly after several thousand farmers stormed the opening legislative sessions in each state, disrupted proceedings, and demanded immediate foreclosure relief.[2] Before the enactment of the Minnesota law, the state's governor threatened to impose martial law over the deteriorating foreclosure climate and issued an executive order to sheriffs statewide to cease conducting foreclosure sales and evictions.[3] One commentator who was involved in drafting legislation at the Minnesota capitol at the time described the climate in the legislature as a "flood of bills" poured in:

> It was proposed, for example: that the courts be closed to all mortgage foreclosure proceedings for two years; that the power to foreclose by advertisement be abolished; that sheriffs be given the power to postpone foreclosure sales at their discretion; that the courts be given the power to continue all foreclosure proceedings for two years upon such terms as should appear to them to be appropriate; that the period of redemption be extended arbitrarily one year, or two; and that henceforth there should be no personal liability upon any note or debt secured by a mortgage after the mortgage had been foreclosed.[4]

During 1933 and 1934 many states enacted statutes that actually achieved most of these objectives. State legislatures drafted these laws with care in hopes of surviving constitutional challenges. The statutes authorized stays of foreclosure proceedings and extensions of post-sale redemption periods, often lasting for several years. Borrowers were given the power to turn non-judicial foreclosures into judicial foreclosures. State legislation provided tools for courts to restrict the harshness of deficiency judgments.[5] Some prominent examples of these laws will be discussed below.

A. Moratorium/Stay of Proceedings in Depression-Era Legislation

Moratorium laws enacted during the thirties applied to both nonjudicial and judicial foreclosures. Yet, for the most part, these statutes were drafted carefully to incorporate judicial supervision over any stay of foreclosure. Almost uniformly, the laws imposed some form of payment obligation upon borrowers as a condition to the continuation of a stay. Several types of

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Legislative Relief for the Mortgage Debtor During the Depression, 5 LAW & CONTEMP. PROBS. 517 (1938).

2. *See* Timothy D. Benton, *Iowa's Mortgage Moratorium Statute: A Constitutional Analysis*, 33 DRAKE L. REV. 303, 307-08 (1984); William L. Prosser, *The Minnesota Mortgage Moratorium*, 7 S. CAL. L. REV. 353, 355 (1934).

3. *See* Prosser, *supra* note 2, at 355.

4. *See id.* at 356.

5. Clifford C. Hynning, *Constitutionality of Moratory Legislation*, 12 CHI.-KENT L. REV. 182, 183-84 (1934) (outlining tools provided to courts).

statutory schemes were typical. Most moratorium laws followed the examples of the four state statutes discussed below.

1. The Iowa Moratorium Statute

Iowa was and remains a judicial foreclosure state. Its initial moratorium statute—enacted in February 1933—authorized a borrower to apply to a court for an order continuing a pending foreclosure action until March 1, 1935. The statute gave courts the authority to prohibit entry of a foreclosure judgment while the stay remained in effect. The borrower had the right to remain in possession of the property during the stay period. However, the statute created a procedure for the courts to require the borrower to pay to the lender rents, income, and profits generated by the property while the stay remained in effect. A similar process applied to cases in which a foreclosure judgment had already been entered. In these cases the statute extended the state's post-judgment redemption period for two years, subject to similar payment conditions. The statute applied to mortgages executed before its enactment, as well as to pending cases.

Under the Iowa statute, the borrower's initial eligibility for the moratorium was automatic. The lender had the burden of proof of showing that the borrower made the application in bad faith. In a later amendment, this burden of proof changed, and the law required that the borrower establish good faith as a condition to obtaining the stay.[6]

2. The New York Moratorium Statute

New York was another judicial foreclosure state that enacted a foreclosure moratorium statute during the thirties. New York's law also barred foreclosure of mortgages in default, but required the borrower to continue payment of interest and taxes. The law provided that a court would review the borrower's income and expenses related to the property every six months. At its discretion, the court could require the borrower to pay the lender any surplus income over and above what was needed to cover interest and taxes. Essentially, the statute provided for a moratorium only on the payment of the loan principal, with the borrower's payment of interest, taxes, and insurance a condition to continuing the suspension of foreclosure.[7] The court was authorized to terminate the stay upon the borrower's nonpayment of any amounts the court at its discretion had ordered to be paid to the lender.[8]

6. *See* Benton, *supra* note 2, at 310.

7. *See* GLENN, *supra* note 1, § 154.1.

8. *See In re* Chase Nat'l Bank of New York v. Guardian Realties, Inc., 283 N.Y. 350, 363 (1940); *see also* GLENN, *supra* note 1, § 154.1. New York eventually added a requirement that borrowers pay one percent per annum toward principal due as a condition to the stay. This percentage increased over later reauthorizations of the moratorium statute.

In most cases the New York statute did not require that a court conduct any extensive evaluation of the borrower's income and expenses. The requirement to pay interest, taxes, and insurance focused on terms of the particular contract, and these amounts could be readily ascertained. The requirement that the borrower make payments to the lender out of surplus income left over after payment of interest, taxes, and insurance was adopted by a later amendment. This requirement became a factor for income-producing properties such as farms or buildings with rental units. The stay was granted automatically and continued upon compliance with payment terms. The New York statute did not incorporate any kind of "good faith" threshold for the borrower.

3. The California Moratorium Statute

Foreclosures in California during the thirties, as now, were primarily nonjudicial. California's moratorium statute functioned in much the same way as those in judicial foreclosure states. It authorized courts to stay judicial as well as nonjudicial foreclosures. The borrower petitioned a court for this postponement.[9] The petition for postponement could be filed at any time within ninety days after recordation of the notice of default. Also, at any time before expiration of the post-sale redemption period, the borrower could file a petition to extend the redemption period.

Under the California law, the courts exercised their equitable discretion in granting stays. Granting a stay was not automatic, even upon compliance with set payment terms. The borrower's inability to pay was not in and of itself sufficient grounds for relief.[10] The burden of proof of showing a right to relief was on the borrower. The court had discretion to set amounts for payment to the lender as a condition to the granting and continuation of the stay. In setting a payment amount, the court could consider the value of the property and the income derived from it. At a minimum, the borrower was required to pay enough to meet obligations for upkeep, taxes, and insurance. The post-sale period of redemption could be extended on the same grounds and through a similar procedure. There were apparently few legal challenges to these exercises of the courts' traditional equitable discretion related to foreclosures. One commentator noted eight years after the statute's enactment that no trial court decisions related to granting, denial, or termination of a stay had ever been set aside on appeal.[11]

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9. Robert L. Lancefield & Philip K. Verleger, *Moratoria and Stay Laws: Mortgage Moratoria Legislation in California*, 30 CALIF. L. REV. 172, 174 (1942) (discussing procedure for postponing private or judicial sale).

10. *See id.* at 174 (noting discretion provided to courts).

11. *See id.* (observing lack of overruled decisions).

4. The Minnesota Moratorium Statute

Minnesota, another nonjudicial foreclosure state, enacted moratorium legislation during 1933. One aspect of the statute—its authority to extend post-sale redemption periods—became the subject of the leading U.S. Supreme Court decision of the era upholding the constitutionality of state foreclosure moratorium legislation.[12] The Minnesota statute allowed a borrower to apply to a court for a stay of foreclosure for up to two years. As a condition to the stay, the court could require the debtor to pay the income derived from the property, or else pay a fair rental value for the property. The court granting the stay reviewed and approved the amounts to be paid during the moratorium period. At a minimum, the payments would have to cover taxes and insurance. The court could also require that any surplus income derived from the property be paid and applied to the debt.[13] The statute allowed courts to stay the redemption period following a sale for up to two years. All stays were granted on a case-by-case basis.

B. Limitations on Deficiency Judgments through Depression-Era Legislation

Depression-era state legislation protecting borrowers from the harsh effects of foreclosures was not limited to moratorium laws. During this period, most states enacted some form of law limiting post-foreclosure deficiency judgments. In much the same way they attacked the moratorium statutes, lenders challenged these anti-deficiency laws as unconstitutional impairments of their contractual rights. Arguably, the anti-deficiency laws imposed more permanent and substantial modifications of lenders' contractual rights than did the moratorium statutes. During the Depression, property values fell drastically and lenders could buy properties at foreclosure sales for nominal prices. Borrowers' liability for deficiency debts increased commensurately. Deficiency claims were thus a major source of contention for both borrowers and lenders.

1. The New York Anti-Deficiency Statute

In the early thirties, New York enacted a law that allowed courts to calculate deficiency debts based on a property's current fair market value rather than using an artificially low auction sale price. Crediting this higher figure against the deficiency typically produced a substantial reduction of the deficiency debt. The United States Supreme Court reviewed the New York anti-deficiency

12. *See generally* Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398 (1934) (upholding constitutionality of state foreclosure legislation).

13. *See* Ronald C. Amundson & Lewis J. Rotman, *Depression Jurisprudence Revisited: Minnesota's Moratorium on Mortgage Foreclosure*, 10 WM. MITCHELL L. REV. 805, 833-34 (1984) (discussing partial payment under foreclosure stay).

statute twice during the Depression era.

2. *The North Carolina Anti-Deficiency Statute*

North Carolina enacted an anti-deficiency law similar to New York's, but applicable only to certain nonjudicial foreclosure sales. The law applied to nonjudicial sales that resulted in the lender's purchasing the property. The limitation did not apply to sales after judicial foreclosures. Thus, lenders still had the option of pursuing a deficiency claim if they chose to proceed under the more cumbersome and time-consuming judicial procedures. In judicial foreclosures, the courts could continue to perform their traditional role of refusing to confirm sales conducted under unfair circumstances. Thus, under either procedure, lenders now faced obstacles in recovering full deficiency judgments. The North Carolina statute was the first of the new anti-deficiency statutes to be tested before the United States Supreme Court.

3. *Anti-Deficiency Statutes in Other States*

Most states enacted some type of anti-deficiency law during the Depression era, and many of these statutes remain on the books today. Twenty states now limit deficiency claims by requiring use of a property's fair market value rather than the amount of the winning bid to calculate the borrower's debt. Fourteen states now have laws that bar deficiency claims entirely in a significant portion of home foreclosures.

III. CONSTITUTIONAL CHALLENGES TO DEPRESSION-ERA STATE FORECLOSURE RELIEF STATUTES

A. *Background*

Lenders challenged the Depression-era moratorium and anti-deficiency laws as violative of the Contracts Clause of the United States Constitution. Article I, Section 10, Clause 1 of the Constitution provides: "No state shall . . . pass any Law . . . impairing the Obligation of Contracts."[14] The Constitutional Convention added this provision in reaction to a spate of debtor relief laws recently enacted by the states. The founders of the new national government perceived these state laws as inimical to the country's ability to build credit for its enterprises and compete as a growing commercial nation.[15]

The Contracts Clause has never been construed as setting an absolute bar to any state legislation that limited rights created under contracts. During the nineteenth and early twentieth centuries, the courts developed a rule that

14. U.S. CONST. art I, § 10, cl. 1.

15. *See* Samuel R. Olken, *Charles Evans Hughes and the* Blaisdell *Decision: A Historical Study of Contract Clause Jurisprudence*, 72 OR. L. REV. 513, 517-18 (1993).

"remedies" for default were distinct from the underlying contractual "obligation." State laws could regulate remedies but they could not modify contractual obligations.[16] For example, in 1880, the Supreme Court upheld a Rhode Island law that barred imprisonment for debt. In the Court's view, the state law limited only remedies for collection of the obligation and did not impair validity of the obligation itself.[17]

B. Constitutional Challenges to the Depression-Era Moratorium and Stay Statutes

Against this background of judicial interpretation, the Minnesota Foreclosure Moratorium Statute appeared before the Supreme Court in 1933. The case came in the form of an appeal involving the Blaisdells, a couple who owned a boarding home in Minneapolis. Following sale of their property through the state's nonjudicial sale procedure, and fourteen days before their one-year state law post-sale redemption period was set to expire, the Blaisdells went before a Minnesota trial court and asked for a two-year extension of their post-sale redemption rights under the new state moratorium statute. The trial court granted the request. In doing so, the court determined the rental value of the boarding home property to be $40.00 per month. The Blaisdells were ordered to pay this amount monthly to the lender as a condition to a stay continuing for up to two years.

The trial court did not set aside the foreclosure sale. By the court's order the Blaisdells were granted solely an extension of time to keep possession of the property and attempt to redeem. If they could refinance, or otherwise come up with the money to pay off the foreclosure sale price during this time, they could set the sale aside and keep the property. The lender retained the right to claim full title to the home if the Blaisdells did not redeem. The trial court also noted that the property's value exceeded the debt. After paying the $40.00 monthly to the lender for two years the Blaisdells would owe about the same amount to the lender as they did when the stay was initially granted.

After the Minnesota Supreme Court upheld the statute the United States Supreme Court affirmed, holding that the law did not violate the Contracts Clause of the Constitution.[18] In the *Blaisdell* opinion, the United States Supreme Court emphasized that the state law did not fundamentally alter the lender's contract rights. Looking to prior interpretations of the Contacts Clause, the Court construed the Minnesota statute as affecting primarily a remedy and not the underlying mortgage obligation. The law merely allowed a state court to extend a redemption deadline. State courts had traditionally played a role in setting terms of redemption under foreclosure laws, and the

16. *Id.* at 522-36.
17. *See* Penniman's Case, 103 U.S. 714, 717 (1880).
18. *See* Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 447 (1934).

Minnesota statute authorized the courts to act consistently with that well-established practice.[19]

On the broader issue of the state's ability to alter contract rights, the *Blaisdell* Court established a more significant principle. According to the Court, under its police power, a state could act to protect its citizens from economic harm as well as natural disasters. States could modify contract rights under this police power. The potential for states to act in this capacity had to be recognized as an implied condition to any contract: "the reservation of the reasonable exercise of the protective power of the State is read into all contracts."[20] Protecting all citizens from an economic emergency was thus a permissible basis for limited impairment of private parties' contract obligations. Under the Court's test, the pertinent question in assessing the validity of an exercise of the police power became "whether the legislation is addressed to a legitimate end and the measures taken are reasonable and appropriate to that end."[21] In the Blaisdells' case, the Court found that the state's measures were reasonable, particularly because they included significant protections for the mortgagee. The existence of emergency conditions was undisputed. In addition, the legislature had proclaimed the law to be of limited duration.

Summing up its ruling sustaining the Minnesota moratorium law, the *Blaisdell* Court looked to five factors: (1) an emergency existed; (2) the legislation was addressed to a legitimate state end, and not for the advantage of particular individuals; (3) the relief afforded was of a character appropriate to the emergency; (4) the conditions of the relief were reasonable in relation to the creditors' rights; and (5) the legislation was temporary in nature and limited to "the exigency which called it forth."[22]

In future application of the *Blaisdell* criteria, the major source of contention would be the fourth factor: whether the contract restriction imposed on the creditor was reasonable and appropriate in view of the emergency at hand. This is inherently a pragmatic and fact-based determination, one that does not always provide a basis for reliable predictions.[23] In *Blaisdell*, the Court majority repeatedly focused on the aspects of the Minnesota statute that left the most significant terms of the mortgagee's claim unimpaired:

> The statute does not impair the integrity of the mortgage indebtedness. The obligation for interest remains. The statute does not affect the validity of the sale or the right of a mortgagee-purchaser to title in fee, or his right to obtain a deficiency judgment, if the mortgagor fails to redeem within the prescribed period. Aside from the extension of time, the other conditions of redemption

19. *See id.* at 446-47.
20. *See id.* at 443-44.
21. *See id.* at 438.
22. *See Blaisdell*, 290 U.S. at 444-47.
23. *See* Olken, *supra* note 15, at 591-602.

remain unaltered. While the mortgagor remains in possession he must pay the rental value.[24]

The year after its *Blaisdell* ruling, the Supreme Court in a unanimous decision in *W.B. Worthen Co. v. Kavanaugh*[25] invalidated an Arkansas statute that had recently been enacted to protect borrowers facing foreclosure.[26] Here again the Court's approach was fact-based, and emphasized what it considered unreasonable and inappropriate restrictions upon the mortgagees' contract rights.[27] The overly burdensome restrictions in the Arkansas law included: (1) an increase in the minimum period after default before foreclosure could be initiated from sixty-five days to two and one-half years; (2) a decrease in the statutorily allowed "default penalty" interest rate from twenty percent to three percent; (3) suspension of the mortgagor's obligation to pay attorney fees and costs in connection with a foreclosure; and (4) a provision allowing the debtor to remain in possession of the property for four years after foreclosure with no interim protections for the lender.[28] This latter provision applied to pending cases, and the statute as a whole applied retroactively to contracts entered into before its effective date. The combination of all of these features led the Court to find the law's impact on contract rights to be unreasonable and the statute an unconstitutional exercise of the state's police power.

The Supreme Court's final consideration of one of the Depression-era moratorium statutes took place in 1945 with *East New York Savings Bank v. Hahn*.[29] At issue was the validity of the New York legislature's continuing extension of its 1933 foreclosure moratorium. As discussed above, the New York moratorium law provided limited relief to debtors in the form of delay of principal payments, and this stay was subject to extensive court review and potential payment conditions. The substantive terms of the New York statute were not at issue in this appeal, with the Court noting that since *Blaisdell*, "there are left hardly any open spaces of controversy concerning the constitutional restrictions of the Contact Clause upon moratory legislation referable to the depression."[30] The New York statute, unlike the Arkansas law invalidated in *Kavanaugh,* did not display a "studied indifference to the interests of the mortgagee or to his appropriate protection."[31] With respect to the issue of the statute's extension well past the initial "emergency" that led to its enactment, the Court expressed a strong inclination to defer to the judgment

24. *See* Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 425 (1934).
25. 295 U.S. 56 (1935).
26. *Id.* at 63 (reversing decree and remanding).
27. *See id.* at 60-61.
28. *See id.*
29. 326 U.S. 230 (1945).
30. *See id.* at 231.
31. *See id.* at 234 (quoting W.B. Worthen Co. v. Kavanaugh, 295 U.S. 56, 60 (1935)).

of the state legislature and the governor who had deemed the conditions in the state sufficient justification for a further extension of the 1933 moratorium law.[32]

C. Challenges to Depression-Era Anti-Deficiency Statutes

The Supreme Court upheld Depression-era state laws that restricted mortgagees' deficiency claims on three different occasions.[33] The decisions involved recent enactments that applied prospectively as well as retroactively to existing mortgages. In the first of the three cases, *Richmond Mortgage & Loan Corp. v. Wachovia Bank & Trust Co.*,[34] the Court rejected a challenge to North Carolina's fair market value limitation on deficiency judgments.[35] The new North Carolina restriction on deficiency claims applied only to nonjudicial foreclosures in which the lender purchased the property at the sale. The law allowed the debtor to initiate a proceeding in which the court could reduce a deficiency claim by an amount the court determined to be the "true value" of the property. The statute did not limit the lender's ability to seek a full deficiency judgment if it agreed to forego the nonjudicial foreclosure process and use the state's alternative judicial foreclosure procedures instead.

In upholding the North Carolina law, the Court emphasized that the lender's right to enforce a deficiency claim in a nonjudicial foreclosure had been created by the state legislature.[36] Given that state legislation created the nonjudicial foreclosure remedy, the parties entered into their contracts with the knowledge that the state legislature could take those remedies away or alter them in the future. Limiting remedies available under the nonjudicial foreclosure statutes, therefore, did not violate any of the lenders' constitutionally protected contractual rights. According to the Court, "[t]he particular remedy existing at the date of the contract may be altogether abrogated if another equally effective for the enforcement of the obligation remains or is substituted for the one taken away."[37] The equally effective remaining remedy for lenders in North Carolina existed under the state's judicial foreclosure proceedings, where subject to court scrutiny and albeit within the context of a more time-consuming proceeding, the lender could still pursue its full monetary claim against the borrower.[38]

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32. *See id.* "Appellant asks us to reject the judgment of the joint legislative committee, of the Governor, and of the Legislature, that the public welfare, in the circumstances of New York conditions, require the suspension of mortgage foreclosure for another year." *Id.*

33. *See, e.g.*, Gelfert v. Nat'l City Bank of N.Y., 313 U.S. 221 (1941); Honeyman v. Jacobs, 306 U.S. 539 (1939); Richmond Mortg. & Loan Corp. v. Wachovia Bank & Trust Co., 300 U.S. 124 (1937).

34. 300 U.S. 124 (1937).

35. *See generally id.*

36. *See id.* at 128-29.

37. *See id.*

38. *Richmond Mortg. & Loan*, 300 U.S. at 129 (outlining alternative remedies).

In *Honeyman v. Jacobs*[39] the Court applied its reasoning from *Richmond Mortgage & Loan* and reached a similar result in an appeal testing the constitutionality of the anti-deficiency provision recently added to the New York judicial foreclosure statutes.[40] The Court found that New York's fair market value limitation on the scope of deficiency claims in judicial foreclosures was a reasonable extension of the equitable powers that courts traditionally exercised in judicial foreclosures.

By the time of the *Gelfert v. National City Bank of New York*[41] ruling in 1941, the Court no longer felt bound to require findings of emergency conditions to justify the limitation the State of New York imposed on deficiency claims in the exercise of its police power.[42] Nor did the Court require that there be a substantially similar alternative remedy through which the lender could recover its full deficiency claim. The Court simply held that the state acted reasonably when it treated the lender's deficiency claim as a windfall rather than a constitutionally protected property right. A state could regulate foreclosures, including the imposition of limits on a deficiency claim, as long as it allowed the lender to be made whole through the foreclosure process. New York did this by allowing the lender to recover the indebtedness as reduced by the current market value of the security property. According to the Supreme Court, the New York legislation did no more than codify basic equitable principles that state courts had always applied in foreclosure actions.[43]

IV. THE SUPREME COURT'S CURRENT CONTRACTS CLAUSE STANDARD: THE *ENERGY RESERVES* CASE

Contracts Clause cases have not appeared frequently on the United States Supreme Court's docket over the past fifty years. It has been over thirty years since the Court last struck down a state law on Contracts Clause grounds.[44]

39. 306 U.S. 539 (1939).
40. *See generally id.*
41. 313 U.S. 221 (1941).
42. *See id.* at 235.
43. *See id.* at 233-34.

> But there is no constitutional reason why in lieu of the more restricted control by a court of equity the legislature cannot substitute a uniform comprehensive rule designed to reduce or to avoid in the run of cases the chance that the mortgagee will be paid more than once. Certainly under this statute it cannot be said that more than that was attempted. The "fair and reasonable market value" of the property has an obvious and direct relevancy to a determination of the amount of the mortgagee's prospective loss. In a given case the application of a specified criterion of value may not result in a determination of actual loss with mathematical certitude. But "incidental individual inequality" is not fatal.

Id. (internal citations omitted).

44. *See* Allied Structural Steel Co. v. Spannaus, 438 U.S. 234, 250-51 (1978) (striking down Minnesota

The Court's last significant articulation of Contacts Clause standards came in 1983, in the case of *Energy Reserves Group, Inc. v. Kansas Power & Light Co.*[45] In *Energy Reserves*, the Court upheld a Kansas statute that set price caps on intrastate natural gas sales.[46] The Court reaffirmed its prior analysis from *Blaisdell* and focused on, among other factors, the extent of preexisting state regulation of the subject matter in question—the sale of natural gas. Under this standard, the more extensive the preexisting state regulation of an industry at the creation of the contract, the weaker a party's later argument will be that a subsequently enacted state law substantially impaired a property right. According to the *Energy Reserves* Court, "state regulation that restricts a party to gains it reasonably expected from the contract does not necessarily constitute a substantial impairment."[47]

Consistently with prior Contracts Clause decisions, the *Energy Reserves* Court did not require the finding of a temporary emergency behind the enactment of the statute.[48] Instead, the question posed was a more general one: were the price ceilings a reasonable means to accomplish a legitimate end? Protecting consumers from unsettling fluctuations in gas prices was clearly a legitimate end. The Court held it appropriate to give substantial deference to the state's selection of reasonable means to promote this end.

The currently operative "test" for Contracts Clause validity, as articulated by the *Energy Reserves* Court, builds upon the *Blaisdell* formulation.[49] It asks the following three questions: (1) is there in fact a substantial impairment of the creditor's contractual rights?; (2) if yes, the state must have a significant and legitimate public purpose behind the regulation, such as the remedying of a broad and general social or economic problem; (3) if this is a significant and legitimate public purpose, the adjustment of the rights and responsibilities of the contracting parties must be based upon reasonable conditions and of a character appropriate to the public purpose supporting the legislation.[50]

Under this standard, if a law satisfies the second and third prongs of the test, a court will uphold the law despite a substantial impairment of contractual rights under the first prong.[51] The *Energy Reserves* test thus steps back substantially from the "remedy" versus "obligation" dichotomy of earlier Supreme Court jurisprudence. It acknowledges that state laws may impair underlying obligations in a proper exercise of the police power. The Court, in *Blaisdell* and *Honeyman* struggled to pay lip service to the nineteenth century

law mandating certain pension holdings by employers).

45. 459 U.S. 400 (1983).

46. *See id.* at 421 (affirming judgment of Kansas Supreme Court).

47. *See id.* at 411.

48. *See id.* at 412. *See generally* Gelfert v. Nat'l City Bank of New York, 313 U.S. 221 (1941); Veix v. Sixth Ward Bldg. & Loan Ass'n, 310 U.S. 32 (1940).

49. *See Energy Reserves*, 459 U.S. at 412.

50. *See id.* at 411-12.

51. *See* Energy Reserves Grp., Inc. v. Kan. Power & Light Co., 459 U.S. 400, 411-12 (1983).

distinction between remedies and obligations, often characterizing the facts to fit within that analysis, while at the same time shaping legal principles that enunciated a much broader rule for future application.[52] The *Energy Reserves* decision gives a more unreserved endorsement of the broad standards formulated in *Blaisdell* and other Depression-era Supreme Court decisions.

In light of the *Energy Reserves* ruling, the existence of a temporary emergency is no longer an essential criterion for passing the Contracts Clause test; nor must the state show that its law affects only what might be characterized as contractual "remedies." Yet, the imprint of the *Blaisdell* standards survives to a limited extent in the *Energy Reserves* formulation. For example, a state law will certainly be more likely to satisfy the *Energy Reserves* "significant and legitimate purpose" standard if a serious crisis compelled its enactment. The current mortgage foreclosure crisis, with its devastating impact on the entire economy, clearly meets this second *Energy Reserves* standard. Similarly, it will be easier to satisfy the standard for the "reasonable" and "appropriate" character of the state regulation under the third prong of the *Energy Reserves* test if the state law can be characterized as applying only to remedies rather than impairing the creditor's underlying contract rights.

For the past seventy-five years the Supreme Court's guidance on Contracts Clause construction has, for better or worse, been flexible. While greater predictability would be more desirable, the standard remains open to pragmatic, fact-intensive, and creative arguments that a state has acted to meet a specific need for relief for debtors and has simultaneously provided reasonable protections for creditors.

V. 1980S STATE FORECLOSURE MORATORIUM AND MEDIATION LEGISLATION—STATE APPELLATE COURT RULINGS

A. Introduction

During the recession of the early 1980s, unemployment and a faltering

52. *See* Honeyman v. Jacobs, 306 U.S. 539, 542 (1939) (highlighting courts' difficulty distinguishing between remedies and obligations); Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 429-31 (1934). In its earlier decision the Minnesota Supreme Court had also upheld the moratorium statute, but expressed no qualms about recognizing that the state law impaired contractual obligations. *See* Blaisdell v. Home Bldg. & Loan Ass'n, 249 N.W. 334, 335 (1933), *aff'd*, 290 U.S. 398 (1934). The Minnesota court considered the impairment to be justified as a reasonable exercise of the state's police power. *See id.* Similarly, in the United States Supreme Court's *Blaisdell* decision, the dissent saw the state law as unambiguously allowing the impairment of contact obligations. *See Blaisdell*, 290 U.S. at 479-83 (Sutherland, J., dissenting) (distinguishing statute in question from previously allowed state interferences with contractual terms). In the Justice Sutherland's view, under the existing contract the Minnesota lender had a present right to take possession of the security property, then sell it or do with the property as it chose. *See id.* at 478. The new state law impaired that power in an unanticipated and drastic manner. *See id.* In hindsight, perhaps the Minnesota Supreme Court decision and Justice Sutherland's dissenting opinion offered the more accurate characterization of the effect of the Minnesota law on the creditor.

agricultural sector led to the reappearance of state legislation intended to protect borrowers from foreclosure.[53] Iowa, Minnesota, Kansas, North Dakota, and Oklahoma took action to limit farm foreclosures through various types of moratorium and stay legislation. Iowa, Minnesota, and South Dakota enacted mandatory mediation statutes that stayed foreclosure until and unless creditors complied with mediation requirements designed to explore alternatives to foreclosure. In addition, Connecticut enacted a moratorium program to protect unemployed homeowners. While the United States Supreme Court did not review any of these enactments, state appellate courts considered several of them under state and federal constitutional provisions. The new laws met with mixed results.

B. Decisions Upholding 1980s State Mandatory Mediation Statutes

In 1986, both Minnesota and Iowa enacted mandatory mediation statutes that required lenders to negotiate with borrowers and certify compliance with the mediation requirements before proceeding to foreclosure. Both statutes applied retroactively to existing mortgages. Lenders challenged the Minnesota law under the similar contracts clauses of the United States and Minnesota constitutions.

A state appellate court upheld the Minnesota mediation statute in *Laue v. Production Credit Ass'n of Blooming Prairie*.[54] The Minnesota statute allowed a debtor to stop foreclosure proceedings for a period of ninety days or until a mediation could be concluded. Addressing the Contracts Clause challenge, the court did not find this instance of contractual impairment any more significant than what occurred under the previous Minnesota law upheld in *Blaisdell*. According to the *Laue* court:

> The seriousness of the farm crisis and its orderly alleviation are legitimate public purposes for legislative action. By limiting the time for mediation, imposing obligations of good faith upon participating debtors and creditors, and repealing the act effective July 1, 1988, the legislature has carefully tailored the means to protect the public purpose without unreasonably burdening creditors.[55]

Considering a similar challenge, the Iowa Supreme Court in *First National Bank in Lenox v. Heimke*[56] noted that Iowa's mediation statute resembled

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53. *See generally* Amundson & Rotman, *supra* note 13; Benton, *supra* note 2; Robert M. Lawless, *The American Response to Farm Crises: Procedural Debtor Relief*, 1988 U. ILL. L. REV. 1037; Diana Sclar, *Mortgage Foreclosure Relief—Connecticut and Minnesota Act to Protect the Unemployed*, 12 REAL EST. L.J. 366 (1984).

54. 390 N.W.2d 823 (Minn. Ct. App. 1986).

55. *See id.* at 829.

56. 407 N.W.2d 344 (Iowa 1987).

Minnesota's recently enacted law and applied the Iowa statute retroactively to pending cases.[57] The Iowa Supreme Court, however, did not reach the constitutional issue directly. After reversing the trial court on the issue of the statute's applicability to foreclosures pending at the time of enactment, the Iowa Supreme Court remanded the matter to the trial court for further deliberation.

Although the Minnesota mediation statute applied to nonjudicial foreclosures and the Iowa statute regulated judicial foreclosures, both laws provided for case-by-case court supervision over the mediation process. Both statutes allowed the creditor to limit the stay by showing individualized hardship—"irreparable harm" under the Iowa statute and "bad faith" by the debtor under the Minnesota statute.

C. Decisions Invalidating 1980s State Moratorium Statutes

1. The Oklahoma Statute

Oklahoma enacted the Mortgage Foreclosure Moratorium Act in 1986, which prohibited the state's farm lending banks from initiating foreclosures for one year. The act did not provide for individualized proceedings under court supervision, but applied automatically to bar agricultural banks from instituting foreclosures in their names. The act allowed agricultural banks to assign their loans to the state guaranty agency that insured the loans. The Oklahoma act's stay provisions did not apply to the state guaranty agency. This agency maintained authority to restructure loans and foreclose when it deemed appropriate during the year when the act would otherwise have barred the banks from foreclosing. Under the act, a court had no discretion to determine the length of the stay that applied to the banks currently holding the loans and there were no requirements for payment of interest, taxes, or fair market rent during the stay period.

In a four-to-three split decision, the majority of the Oklahoma Supreme Court invalidated the 1986 Foreclosure Moratorium Act in *Federal Land Bank of Wichita v. Story*.[58] The court considered the limitation that allowed only the state guaranty agency to foreclose to be unreasonable:

> State action which forces such a divestment to gain access to state court destroys the mortgagee's contractual rights. The statute denies all remedy to the mortgagee during the life of the Act. The alternative remedy is neither equally effective for the enforcement of the obligation nor does it substitute for

57. *Id.* at 346 (comparing instant case with *Laue* litigation).
58. 756 P.2d 588, 593 (Okla. 1988).

the remedy taken away.[59]

The three dissenting justices deferred to the legislative findings that the law was appropriate to the existing emergency and based upon reasonable conditions. According to the dissenting justices, the suspension of foreclosure was for a definite and reasonable time. During this period the mortgagee had the option of assigning the mortgage to a guarantor for foreclosure. In the minority's view, the statute's restrictions were not as pervasive as the majority portrayed them: "[t]he present legislation does not divest permanently mortgagees of the existing remedy of foreclosure nor temporarily of all remedy."[60]

2. The Kansas Statute

The Kansas legislature enacted the Family Farm Rehabilitation Act in 1986, only to have the Kansas Supreme Court promptly strike it down as a violation of the Contracts Clause of the United States Constitution in *Federal Land Bank of Wichita v. Bott*.[61] The Kansas statute imposed a number of alterations on existing mortgagor/mortgagee relations. It allowed borrowers to apply for a stay of foreclosure lasting one year, with possible renewals for two more years. A court could condition the stay upon the borrower's payment of insurance, prevention of waste, and allowance of inspections. Instead of paying the amount of the foreclosure judgments, a borrower could pay the fair market value of his property, an amount typically lower than the judgment. Upon redemption, the borrower could acquire the property free and clear of the mortgage, and the lender would be "left without security for the difference between the redemption amount and the judgment amount."[62] The Kansas act retrospectively lowered the contract rate of interest accruing during the redemption period and created a new right of the borrower to redeem a part of the total acreage from foreclosure. The statute also prevented lenders from bidding at a judicial sale or obtaining a deficiency judgment.[63]

The *Bott* court considered whether the Kansas legislation had set "reasonable conditions" on the creditors' rights, as required under *Blaisdell* and *Energy Reserves*.[64] The court compared the contractual limitations described above to those found in *Blaisdell*:

> *Blaisdell* considered it essential that the integrity of the mortgage indebtedness

59. *See id.*
60. *See id.* at 596 (Hodges, J., dissenting).
61. 732 P.2d 710, 718-19 (Kan. 1987).
62. *See id.* at 717.
63. *See id.* at 718.
64. *See id.*

> not be impaired; that the interest pursuant to the contract continue to run; that the mortgagee have the right to a title to the security or to obtain a deficiency judgment; that the conditions of redemption, if it occurs, stand as they were under the prior law; and that the mortgagor, if he retains possession during the extended redemption period, pay a reasonable rental.[65]

In light of this *Blaisdell* comparison, the court faulted the Kansas statute, holding the modification of the redemption payment to be an impairment of the mortgage debt. Next, the court interpreted the lowering of the interest rate accruing during the redemption period as a change from the contract rate. The court also opined that the right to redeem in parcels affected the lender's substantive rights. Finally, in the court's view, the provisions for "adequate assurance" payments to be made during a stay period were neither specific nor mandatory.

The *Bott* court took a severely restrictive view of the Contracts Clause. The deficiency limitations in the Kansas statute were no more substantial than the prohibition on deficiencies that the United States Supreme Court upheld in *Gelfert*.[66] The provisions related to post-judgment interest and partial redemption applied to post-judgment remedies, and did not "impair" the underlying obligation. The statute required a court to set payments for the borrower to make while any stay was in effect. In *Bott*, the trial court invalidated the statute on its face and never held a hearing to determine adequate assurance payments. Therefore, the record was unclear as to how this provision for ongoing payments would actually impact the creditor.

3. The Iowa Redemption Statute

Iowa enacted legislation in 1987 that affected mortgage relations in two ways. First, the statute extended the redemption period for agricultural homesteads from one year to two years. The statute also allowed mortgagors to redeem the property by paying the fair market value rather than the judgment amount. In *Federal Land Bank of Omaha v. Arnold*,[67] lenders challenged the statute on a number of grounds, including a claim that the statute's provisions violated their rights under the Contracts Clause of the United States Constitution.[68] The Iowa Supreme Court, in agreeing with the lenders,

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65. *See Bott*, 732 P.2d at 718.

66. *Id.* at 713 (listing attributes of Kansas statute's deficiency limitations). The decision's discussion of the statute's treatment of deficiency claims is unclear. The opinion reports that the Kansas statute expressly preserved deficiency claims. *See id.* The court, however, later faults the statute for preventing a mortgagee from obtaining a deficiency. *See id.* at 718.

67. 426 N.W.2d 153 (Iowa 1988).

68. *See id.* at 156. The lenders also claimed that the legislation denied them equal protection and violated their due process rights under the Fourteenth Amendment to the United States Constitution and Article 1, Sections 6 and 9 of the Iowa Constitution. *Id.* at 155-56. Moreover, the lenders challenged the legislation as violative of the Supremacy Clause of the United States Constitution. *Id.* at 156.

considered the Iowa statute in light of the United States Supreme Court's rulings in *Blaisdell* and *Kavanaugh* and found the severity of the statute's restrictions placed it somewhere between the two.[69] Several aspects of the statute particularly concerned the *Arnold* court, however. The use of the fair market value standard for redemption and the extension of the redemption period to two years had been imposed upon a creditor whose claim had already been reduced to judgment. It was the combination of these two retroactive changes that, in the court's view, crossed the line and failed to leave "the integrity of the mortgage indebtedness unimpaired."[70] It appeared to be the particular combination of the two foreclosure restrictions at issue that concerned the court. Each of the limitations had been present in some of the state laws upheld by the United States Supreme Court during the Depression era.

VI. SUMMARY OF MAJOR ISSUES ADDRESSED IN CONTRACTS CLAUSE FORECLOSURE RULINGS

A. Payment of Interest and Income from Property as a Condition to Relief from Foreclosure

What seems striking today in looking back at many of the Depression-era statutes, particularly the moratorium laws, is the degree to which the statutes accommodated lenders. Most of these statutes set strict conditions for payment of certain basic charges as a condition to a stay of foreclosure. Often, these payments went beyond taxes and insurance, and included interest and amounts which represented "income" from the property. This focus on the income-producing capacity of the mortgaged property was likely a reflection of the significant number of farm homesteads involved in foreclosures. In the 1930s, the rates of homeownership were significantly lower than they are now, and farms made up a much larger portion of the owner-occupied properties than they do today. While most family farmers were not producing any significant surplus income during the Depression, the idea that lenders should be entitled to some portion of any surplus income derived from use of the property during a stay certainly heightened the appearance of fairness to lenders. Similarly, the Blaisdells in Minnesota owned a fourteen-room boarding house in which they also lived. Given the commercial use of their home, it would have been hard to

69. *See id.* at 160.

70. *See id.* (holding retroactive application of old judgments unreasonably impaired integrity of prior judgments). The court stated that prospective application of the redemption adjustments would meet the *Blaisdell* standard as the lenders could have adjusted future bids to reflect the fair market value of the agricultural homestead. *Id.* Because the statute applied retroactively to default judgments already granted, however, allowing mortgagors to pay only the fair market value would create unreasonable risks for lenders in that they could lose a substantial portion of their judgment. *See id.*

argue that the Minnesota court acted harshly in requiring that the Blaisdells make monthly payments of $40.00 to the lender during the two year moratorium period allowed by the court pursuant to the statute.

Compared to borrowers during the Great Depression, today's homeowners are much less likely to be living in a property that produces a regular income. A provision requiring that homeowners pay interest as a condition to a moratorium on foreclosure would make the remedy useless for most homeowners facing foreclosure today. A large portion of homeowners now in foreclosure took out the subject loans within the past five to eight years. The homeowners' payments consist almost entirely of interest and other non-principal items, such as taxes and insurance. Often the high interest rates themselves are a major cause of the foreclosure. Therefore, a moratorium that stayed only the obligation to pay toward principal, such as the 1930s New York statute, would provide no assistance for most homeowners facing foreclosure today.

Significant deflation in property values characterized the Depression era, as it does the housing market today. The effect of this deflation on prices bid at foreclosure sales was a major concern for legislators during the 1930s. Much of the state remedial legislation was designed to alleviate the harsh effects of foreclosure sales that were producing only nominal bids. Thus, a major purpose of state moratorium legislation was to postpone foreclosure sales to a time when market conditions would hopefully produce higher bids. Future increases in real estate values would also allow homeowners to refinance or sell their properties, so as to preserve or recoup equity. Similarly, the limits states placed on deficiency judgments were intended to alleviate the harsh effects of low bidding in the severely depressed real estate market.

B. The Role of the Judiciary

The Supreme Court decisions that upheld state legislation protecting borrowers during the Great Depression were uniform in their inclusion of provisions allowing for close court supervision over foreclosure relief. The courts had always performed a function of ensuring basic fairness in foreclosures. By focusing on the role of state courts in monitoring relief from foreclosure on a case-by-case basis, the Supreme Court was able to characterize the new state legislation as merely an extension of centuries-old judicial practice.

C. The Role of Lender Misconduct

Deflated property values and low bids at foreclosure sales are common during the current foreclosure crisis, as they were in the 1930s. However, issues related to lender misconduct are an added element present today, which were not encountered as frequently during the Depression. Much more so than

in the past, the home mortgage lending industry played a significant role in creating the current financial crisis. Today, legislative responses to the foreclosure crisis will fall short to the extent they fail to take this new development into account. Servicers play a key role in determining the outcome of foreclosures today. Most servicers foreclosing today are recipients of substantial largesse from the American taxpayers. These servicers have signed contracts with the federal government agreeing to modify loans under binding federal guidelines. This raises the question as to what extent a servicer's ability to foreclose may be limited by the state for failure to comply with obligations under the federal contract.

VII. STATE RESPONSES TO THE CURRENT FORECLOSURE CRISIS—CONSTITUTIONAL ISSUES RELATED TO MANDATING MEDIATION AND LOSS MITIGATION

This section will examine constitutional issues raised by some of the state responses to the upsurge in home foreclosures that began in 2007 to 2008. Two characteristics of the current crisis guided many of these state efforts. First, loan modifications came to be seen as a desirable alternative to foreclosure.[71] This led several states to enact laws designed to encourage the modification of home mortgage loans in foreclosure. Second, state legislatures attempted to control the practices of mortgage servicers. Certain state legislation responded to widespread perceptions that many servicers' practices were discouraging loan modifications and increasing the number of unnecessary foreclosures. The Federal Government's Home Affordable Modification Program (HAMP), announced in early 2009, was designed to regulate the actions of servicers

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71. *See, e.g.*, MAJORITY STAFF OF THE JOINT ECON. COMM., 110TH CONGRESS, THE SUBPRIME LENDING CRISIS: THE ECONOMIC IMPACT ON WEALTH, PROPERTY, VALUES AND TAX REVENUES, AND HOW WE GOT HERE (2007), http://www.jec.senate.gov/archive/Documents/Reports/10.25.07OctoberSubprimeReport.pdf (citing growing awareness among policy makers and regulators to prevent continued foreclosure wave through modifications); Cheyenne Hopkins, *Modification: Tentative Steps Towards a Regulatory Consensus*, AM. BANKER, Nov. 27, 2007, *available at* 2007 WLNR 23373275 (declaring widespread acceptance of need to modify non-delinquent hybrid subprime mortgages); Am. Securitization Forum, Press Release, Statement of Principles, Recommendations and Guidelines for a Streamlined Foreclosure and Loss Avoidance Framework for Securitized Subprime Adjustable Rate Mortgage Loans (Dec. 6, 2007), *available at* http://www.americansecuritization.com/uploadedFiles/FinalASFStatementonStreamlinedServicingProcedures.pdf (advocating minimizing foreclosures and preserving home ownership in best interests of all market participants); Sheila C. Blair, FDIC Chairman, Remarks at American Securitization Forum Annual Meeting (June 6, 2007), *available at* http://www.fdic.gov/news/news/speeches/archives/2007/chairman/spjun0607.html (highlighting consensus that loan modifications creating sustainable mortgages constitute best option for investors and borrowers); Henry Paulson, Sec'y of the Treasury, Remarks at the Office of Thrift Supervision National Housing Forum: Actions Taken and Actions Needed in U.S. Mortgage Markets (Dec. 3, 2007), *available at* https://ustreas.gov/press/releases/hp706.htm (outlining Treasury's three-point plan for modifying existing mortgages to prevent foreseeable foreclosures); Press Release, U.S. Dep't of the Treasury, Statement on Loss Mitigation Strategies for Servicers of Residential Mortgages (Sept. 4, 2007), *available at* http://www.occ.treas.gov/news-issuances/bulletins/2007/bulletin-2007-38a.pdf (stating Treasury indicated servicers may modify terms of loan when delinquency reasonably foreseeable).

conducting foreclosures and mandate loan modifications in certain situations. Some state laws enacted in 2009 and 2010 were aimed to ensure servicers complied with obligations they undertook in signing agreements to participate in the HAMP program.

Foreclosure can result in substantial losses for the investors in mortgage debt.[72] Loan modifications become attractive when the expected loss from foreclosure can be estimated and compared to the likely loss from modifying a loan to create affordable terms for the borrower. "Net present value" tests, discussed below, allow mortgage holders to estimate the costs of the foreclosure and non-foreclosure option on a case-by-case basis. After calculating the cost of both options, the servicer can select the least costly option for investors. Some new state laws required consideration of a net present value test for loan modification before allowing a foreclosure sale.

Foreclosure mediation laws became an attractive option for states. Mediation offers a vehicle both to encourage modifications and hold servicers accountable for review of the option. Servicers typically express concerns about delays inherent in some mediation programs. In addition, to the extent that the mediation laws may require loan modifications and other loss mitigation options to be implemented, Contracts Clause and Takings Clause issues may be implicated. The nature of the possible constitutional claims will be discussed below.

A. Structure of State Foreclosure Mediation and Conference Statutes

Between mid-2008 and late 2010, eleven states enacted statutes requiring a lender to engage in some form of loss mitigation review with a borrower before proceeding to a foreclosure sale.[73] These statutes require the lender to attempt in some way to confer with the homeowner and consider alternatives to a foreclosure before a sale may take place. The laws vary a great deal in the obligations they impose on lenders. For example, the pre-foreclosure

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72. *See* Alan M. White, *Deleveraging the American Homeowner: The Failure of 2008 Voluntary Mortgage Contract Modifications*, 41 CONN. L. REV. 1107, 1119 (2009) (discussing average losses and failure of mortgage investments). Professor White indicates that as of late 2008, lenders incurred losses averaging $124,000 for each foreclosure. *Id.* As each loan in foreclosure had an average value of $212,000, lenders lost fifty-seven percent of their investment with each foreclosure. *Id.* Average losses on second mortgages subject to foreclosure approached one hundred percent. *Id.*

73. *See* CAL. CIV. CODE §§ 2923.5, .52-.53 (West 2009); CONN. GEN. STAT. § 8-265ee (2009); ME. REV. STAT. tit. 14, § 6321-A (2010); Act of Aug. 7, 2010, ch. 258, 2010 Mass. Acts (S. No. 2407); N.Y. C.P.L.R. 3408 (McKinney 2010); H.R. 590, 2009-2010 Gen. Assemb. (Vt. 2010); H.D. 472, 2010 Gen. Assemb., 427th Sess. (Md. 2010); S. 628, 75th Leg. Assemb. (Or. 2009); Assemb. 149, 75th Leg., Reg. Sess. (Nev. 2009); H.R. 4453-55, 95th Leg., Reg. Sess. (Mich. 2009); S. 492, 116th Gen. Assemb., 1st Reg. Sess. (Ind. 2009) http://www.malegislature.gov/legis/586history/h04866.htm. *See generally*, GEOFFRY WALSH, NAT'L CONSUMER LAW CTR., STATE AND LOCAL FORECLOSURE MEDIATION PROGRAMS: CAN THEY SAVE HOMES? (2009) (outlining structure of state and local programs for conference and mediation in foreclosure cases), *available at* http://www.realestateeconomywatch.com/wp-includes/upload-files/ReportS-Sept09.pdf.

conferences mandated by the statutes enacted in California, Indiana,[74] Massachusetts, Michigan, and Oregon do not require the involvement of a neutral third party to oversee the interactions between the lender and the homeowner. Under these laws, the lender or servicer may proceed with a foreclosure if it certifies that its attorney discussed or attempted to discuss loss mitigation options with the borrower. California, Michigan, Massachusetts, and Oregon are nonjudicial foreclosure states. Allowing servicers to police their own compliance with statutory conference requirements places homeowners in a vulnerable position. Homeowners who dispute a servicer's action must initiate a cumbersome lawsuit, often prepared on an emergency basis, in order to bring the servicer's noncompliance before a court and obtain a stay of the sale.[75]

At the other end of the spectrum, the statutes enacted in Connecticut, Maine, Nevada, New York, and Vermont require foreclosing lenders to participate in proceedings that more closely resemble a traditional mediation or a court-supervised settlement conference. Mediators or other personnel accountable to the courts supervise the settlement discussions. Under the New York program, residential foreclosure cases are automatically assigned to a conference. An amended version of the Connecticut statute also makes all foreclosures involving residential properties eligible for mediation. In Maine, Nevada, and Vermont, borrowers are informed of the option to elect to participate in mediation when they are notified of the commencement of foreclosure proceedings. These homeowners then have a limited time period to opt in to the mediation program.

Maryland, a nonjudicial foreclosure state, enacted a statute providing for a hybrid of the two structures discussed above. Under the Maryland law, as a preliminary matter, a servicer seeking to foreclose must offer the borrowers a

74. *See* IND. STATE COURT ADMIN., RESOURCES FOR STARTING YOUR OWN COURT-BASED SETTLEMENT CONFERENCE PROGRAM, http://www.in.gov/judiciary/admin/mortgage/resources.html (last modified July 6, 2010). Although Indiana's statute of general statewide applicability does not require mediator oversight in conferences, the Indiana Supreme Court encourages counties to implement pilot programs that do include oversight by neutral third parties. Several Indiana counties, including Allen, Lake, Madison, and St. Joseph, implemented these types of programs.

75. A number of California courts held that the state's conference statute did not give homeowners a private right of action to seek judicial enforcement of the law. *See, e.g.*, Kuoha v. Equifirst Corp., No. 09cv1100 WQH (WMc), 2009 WL 3248105, at *5 (S.D. Cal. Oct. 7, 2009); Gaitan v. Mortg. Elec. Registration Sys., No. EDCV 09-1009 VAP (MANx), 2009 WL 3244729, at *6 (C.D. Cal. Oct. 5, 2009); Nool v. HomeQ Servicing, 653 F. Supp. 2d 1047, 1052 (E.D. Cal. 2009); Anaya v. Advisors Lending Grp., No. CV F 09-1191 LJO DLB, 2009 WL 2424037, at *6 (E.D. Cal. Aug. 5, 2009). A California appellate court has ruled to the contrary, however, holding that borrowers do have a private cause of action to enforce the conference law. *See* Mabry v. Superior Court, 110 Cal. Rptr. 3d 201, 204 (Ct. App. 2010); *see also* Ortiz v. Accredited Home Lenders, Inc., 639 F. Supp. 2d 1159, 1166 (S.D. Cal. 2009) (allowing private right of action to enforce conference requirement). Another California appellate court has held that the scope of the borrower's private right of action does not extend to invalidation of a completed sale, despite a servicer's alleged violation of the conference requirement. *See* Davidson v. Superior Court, No. G042926, 2010 WL 2338656, at *2 (Cal. Ct. App. June 11, 2010).

loss mitigation application. The application includes a request for a loan modification. Before the servicer can proceed to schedule a sale, it must file a certification that it reviewed the borrower's application and gave the borrower a written decision on it. A homeowner who is dissatisfied with the servicer's decision can request formal mediation. Mediations are conducted under the auspices of Maryland's Office of Administration Hearings. The statute provides for a further level of review after mediation. A borrower may use an expedited procedure to seek a stay of foreclosure from the courts, raising any claims related to the servicer's pre-foreclosure conduct, including conduct in mediation.

The recent mediation and conference statutes do not raise significant new concerns about states exceeding their authority to interfere with private parties' contract rights. The restrictions on creditors' rights imposed by the laws are of two general types. First, most of these laws impose some form of delay on the foreclosure process, a delay that extends beyond restrictions that were part of the state foreclosure law when the parties entered into the transactions. Second, in the mediation or conference process itself, the laws typically impose new obligations on servicers. The issues related to the additional delay and the servicer obligations merit additional discussion.

1. Foreclosure Mediation Statutes: Delay of Foreclosure

Foreclosure mediation statutes typically impose some new form of delay on foreclosure proceedings. These delays may be in the form of a stay of judicial proceedings or a mandatory hiatus in the nonjudicial foreclosure process. Particularly in states with fast-track nonjudicial foreclosure laws, this delay creates an important window for borrowers. For many servicers, however, the delay can be more controversial because it runs counter to their engrained practices geared toward the prompt recovery of security property after default. Mediation statutes address lenders' concerns in various ways. Several set express time limits within which mediation must be completed. For example, Michigan's mediation statute limits the conference period to ninety days after a borrower makes a timely request for mediation. Connecticut allows sixty days for mediation, with an additional thirty days possible for cause. New York's mediation statute provides that a settlement conference must take place within sixty days after service of the summons and complaint. Under the California law, the servicer must confer with the borrower or exercise due diligence in attempting to contact the borrower during a thirty-day period before filing the initial foreclosure notice.

It is important to consider the delays under the mediation and conference statutes within the context of the preexisting state foreclosure laws. Many states' foreclosure statutes have always incorporated significant periods of delay. Legislatures created these respite periods to give borrowers

opportunities to cure a default before a foreclosure sale or redeem after a sale. Foreclosure mediation schedules may fit within these built-in time periods without substantially disturbing the overall foreclosure timeframe. For example, Nevada's statute provides for mediation during the existing statutory ninety-day period between the filing of the initial statutory notice of intent to foreclose and the earliest time permitted for scheduling a foreclosure sale. Vermont's mediation statute allows the borrower to request mediation up to two months before the expiration of the statutory post-judgment redemption period of six months. Thus, under the Vermont statute, there is a substantial period for mediation to be completed, even after entry of a judgment. Under the Vermont procedure, however, requesting mediation does not toll the running of the redemption period, which expires as it would have before enactment of the new law.

2. Foreclosure Mediation Statutes: Conditioning Foreclosure Sale upon Compliance with Mediation Obligations

None of the recently enacted foreclosure mediation or conference statutes requires that a servicer implement a particular loss mitigation option in a particular set of circumstances. Rather, the statutes focus on the requirement for a "meeting" between the borrower and the servicer's representative. For these meetings, the servicer's representative must be a person authorized to implement loss mitigation options on behalf of the owner of the debt obligation. The statutes typically allow the lender's representative to "meet" with the borrower by phone. Where an in-person meeting is required, the lender's attorney must appear in person. The lender's attorney must be in direct phone contact with a properly authorized representative of the lender. The borrower, and any representative of the borrower, must be physically present as well.

Statutes mandating a fixed time period for negotiations can certainly be helpful for borrowers facing foreclosure. However, servicers who have no interest in seriously considering loss mitigation options can render these statutes of little practical value. Servicers and their attorneys know that they need only wait out the clock. Foreclosure mediation programs have addressed the problem of servicers "going through the motions" in several ways. One approach is for the statute to require that servicers perform specific duties as part of the mediation. The statute may then authorize a court or mediator to prohibit a foreclosure sale until a servicer has complied with these obligations. The foreclosure mediation statutes enacted in Nevada created this type of enforcement mechanism.

Nevada is a nonjudicial foreclosure state that enacted a foreclosure mediation statute in 2009. Under Nevada's law, the servicer must disclose a loan modification analysis to the mediator. The mediator certifies whether the servicer complied in good faith with this and other mediation requirements. A

servicer may not proceed to a sale without the mediator's certification of good faith compliance with mediation obligations. The mediator can also seek enforcement of mediation standards through the courts. In the event of bad faith conduct in mediation, a Nevada district court may order any sanctions it deems "appropriate, including, without limitation, requiring a loan modification in the manner determined proper by the court."[76] To date, no Nevada courts have expressed a willingness to impose a loan modification as a sanction for a servicer's bad faith conduct in mediation.

The Maine and Vermont statutes also impose concrete obligations on a servicer as part of mediation.[77] Maine is a judicial foreclosure state. If the borrower timely requests mediation under Maine's statute, the court will not enter judgment until receipt of a mediator's report.[78] The report must address a number of mediation requirements, including whether the servicer participated in mediation in good faith and produced a net present value calculation using the FDIC Loan Modification Program Guide.[79] This calculation compares the likely loss to investors from modifying a loan with the likely loss they will incur if they proceed directly to foreclosure. The HAMP program requires participating servicers to complete a similar net present value analysis prior to a foreclosure sale.[80] HAMP contracts require that participating servicers go further. Subject to some very limited exceptions, servicers are required to modify a loan if the net present value calculation shows a greater benefit to investors from the modification option rather than the foreclosure option. Under the Maine statute, the court can impose sanctions it deems appropriate if the servicer did not comply in good faith with mediation obligations.[81] Thus, the servicer's failure to complete the net present value analysis would be a basis for denying foreclosure relief under the Maine law. The Vermont statute imposes a similar obligation on servicers to conduct a net present value analysis.[82] In a Vermont mediation, the servicer must disclose its input data for the HAMP net present value calculation and indicate the result of the test.[83] The Vermont law, like the Maine statute, permits a court to deny foreclosure relief if a servicer did not comply with this and other mediation obligations.[84]

Foreclosure mediation statutes enacted in Michigan in 2009, and in Maryland in 2010, do not require that servicers disclose a specific net present

76. Assemb. B. 149, § 1(5), 75th Leg., Reg. Sess. (Nev. 2009).

77. *See* ME. REV. STAT. tit. 14, § 6321-A(3) (2010); H.R. 590, 2009-2010 Leg. (Vt. 2009).

78. *See* tit. 14, § 6321-A(9).

79. *See* tit. 14, § 6321-A(13).

80. *See* MAKING HOME AFFORDABLE PROGRAM, HANDBOOK FOR SERVICERS OF NON-GSE MORTGAGES 45 (version 2.0 2010), *available at* https://www.hmpadmin.com/portal/programs/docs/hamp_servicer/mhahandbook_20.pdf.

81. *See* tit. 14, § 6321-A(12).

82. *See* Vt. H.R. 590, § 4.

83. *See id.*

84. *See id.*

value analysis, such as the FDIC or HAMP calculation, in a conference or mediation session. Instead, the Michigan and Maryland statutes place a more general obligation on servicers to disclose a loan modification analysis. Unlike Nevada, where mediators may seek direct enforcement of the mediation statute in the courts, in Michigan and Maryland the borrower must initiate judicial proceedings in order to bring a servicer's noncompliance with program requirements before a court.[85]

None of the foreclosure mediation statutes enacted thus far authorize a court to modify a loan solely because it became clear through mediation that a loan modification was more beneficial to investors than foreclosure. While the Nevada statute on its face authorizes a court to modify a loan, the court does so only as a sanction against a servicer for bad faith participation in mediation, not because the foreclosure needlessly destroys value for investors.

The statutes enacted in Maine, Vermont, Michigan, Maryland, and Nevada share a common goal of requiring servicers to disclose a loan modification analysis as part of the mediation process. This disclosure can be an important tool for borrowers, and potentially for courts, to analyze the effect of a foreclosure. The borrower may use it in court to support an argument that a particular foreclosure is inequitable. The inequity would occur not only because of the foreclosure's effect upon the homeowner, but also because of the detrimental impact foreclosure would have upon investors—a harm that the loan modification would mitigate. More significantly, the overwhelming majority of servicers have signed contracts with the Treasury Department to participate in the HAMP program. Servicers violate the terms of their HAMP contracts if they proceed to foreclose when a net present value analysis has shown a loan modification to be more beneficial for investors than foreclosure. On a number of contractual and equitable grounds, courts should prohibit foreclosure sales shown to be inappropriate under the net present value tests that servicers must prepare in mediations. Where servicers are foreclosing in violation of HAMP, the rationale for prohibiting foreclosure is significantly more compelling.[86]

85. *See* MD. CODE ANN., REAL PROP. § 485 (West 2010); 2009 Mich. Pub. Acts 16.

86. Outside of the context of a statutory conference or mediation protocol, several states have established requirements for certification of compliance with a review of HAMP eligibility before a servicer may foreclose. *See* 735 ILL. COMP. STAT. 5/15-1508(d)(5) (2010) (authorizing setting aside foreclosure sale before confirmation if borrowers established sale contrary to HAMP guidelines); Mortgage Foreclosure Standing Order Federal Loss Mitigation Programs, Form No. JD-CV-117 (Conn. Super Ct. Aug. 18, 2010) (effective Sept. 1, 2010), *available at* http://www.jud2.ct.gov/webforms/forms/CV117.pdf (requiring compliance with HAMP and other federal loss mitigation programs before judgment in judicial foreclosure); Mortgage Foreclosures and the Home Affordable Modification Program (HMP), Order No. 2009-05-22-01 (S.C. May 22, 2009), *available at* http://www.judicial.state.sc.us/courtOrders/displayOrder.cfm?orderNo=2009-05-22-01 (requiring affidavit of HAMP review filed with foreclosure complaint); Servicing Mortgage Loans: Business Conduct Rules, N.Y. Comp. Codes R. & Regs. tit. 3, §§ 419.1-.14 (2010), *available at* http://www.banking.state.ny.us/legal/ar419tx.htm (imposing duty for participating HAMP servicers to comply with HAMP's timely processing and notice obligations).

3. Recent Developments—Actions by State Supreme Courts

The impetus for the creation of foreclosure mediation and conference programs has come not only from state legislatures, but also the judicial branch. During 2008 and 2009, the supreme courts of Ohio and New Jersey promulgated rules authorizing local courts to initiate foreclosure mediation programs. Prior to these orders, court rules in these states excluded mortgage foreclosure cases from the scope of mandatory alternative dispute resolution programs. In response to the foreclosure crisis, these supreme courts fashioned model procedures adapted specifically to foreclosure cases. Under the Ohio program, local courts could use or modify the supreme court's recommended procedures to meet their own needs. In several of Ohio's most populous counties, the common pleas courts instituted foreclosure mediation programs under this authority.[87] The New Jersey Supreme Court established rules for a uniform statewide foreclosure mediation program.[88] In August 2009, the president judge of the Delaware Superior Court promulgated a mediation rule applicable to all Delaware's superior courts.[89] The foreclosure mediation programs eventually implemented in Ohio, New Jersey, and Delaware permit homeowners to opt in to mediation for a set period of time after service of a summons and complaint.[90]

Florida has been one of the states hardest hit by the foreclosure crisis. A report by the Florida Supreme Court indicated that at the end of 2009, there were 456,000 foreclosure cases pending in the state's courts.[91] A Florida court

87. *See Foreclosure Mediation Contact Information by County*, SUP. CT. OF OHIO, *available at* http://www.supremecourt.ohio.gov/JCS/disputeResolution/foreclosure/ForeclosureCtyContact.pdf (last updated Dec. 16, 2010). Foreclosure mediation programs have been instituted in Cuyahoga County (Cleveland), Franklin County (Columbus), Hamilton County (Cincinnati), Lucas County (Toledo), Montgomery County (Dayton), and Summit County (Akron). *See id.*

88. *See New Jersey Foreclosure Mediation*, N.J. CTS. (Oct. 2009), *available at* http://www.judiciary.state.nj.us/civil/foreclosure/11290_foreclosure_med_info.pdf.

89. *See* Residential Mortgage Foreclosure Mediation Program, Admin. Directive No. 2009-3 (Del. Super. Ct. Aug 31, 2009), *available at* http://courts.delaware.gov/Superior/pdf/Administrative_Directive_2009-3.pdf.

90. As a pilot program, the Hawaii Supreme Court promulgated a similar order in September 2009 applicable to judicial foreclosures in one circuit. *See Statistical Update for the Foreclosure Mediation Pilot Project*, ADR TIMES (Ctr. for Alternative Dispute Resolution, Haw. Judiciary, Honolulu, Haw.), Summer 2010, at 3, *available at* http://www.courts.state.hi.us/docs/CADR/CADR_Nwsltr_2010Sum2.pdf. The Supreme Courts of Iowa, Wisconsin, and New Hampshire also issued orders implementing voluntary foreclosure mediation programs during 2009. *See Two More Counties Launch Foreclosure Mediation Programs*, THIRD BRANCH (Dir. of State Courts Office, Madison, Wis.), Summer 2010, at 3, *available at* http://www.wicourts.gov/news/thirdbranch/docs/summer10.pdf; *Information on Iowa Mediation Service's Mortgage Mediation Program*, IOWA MEDIATION SERVICE, http://www.iowamediationservice.com (last visited Sept. 8, 2010); *Office of Mediation and Arbitration—Foreclosure Mediation Program*, N.H. JUD. BRANCH, http://www.courts.state.nh.us/adrp/foreclosure/structure.htm (last visited Sept. 8, 2010). These programs were statewide in Iowa and New Hampshire and applicable to target localities in Wisconsin (e.g., Milwaukee). Unlike the mediation programs discussed elsewhere in this article, the Iowa, Wisconsin, and New Hampshire orders did not create mandatory mediation requirements. Instead, these programs invited, but did not require, participation by servicers and lenders.

91. *See In re* Final Report and Recommendations on Residential Mortgage Foreclosure Cases, No.

rule authorizes the chief judge of any Florida circuit court to issue administrative orders relating to court procedures.[92] During 2008 and 2009, the chief judges of six of Florida's twenty circuit courts used this authority to implement foreclosure mediation programs.[93] These programs varied, with some mandating conferences for all foreclosure cases filed in the circuit and others facilitating voluntary conferences. After studying the effectiveness of these local programs, the Florida Supreme Court issued an administrative order in December 2009 calling for a uniform statewide foreclosure mediation system.[94] Under the Florida Supreme Court's guidelines, mediation is mandatory, with all foreclosures referred to mediation.[95] Participation is not limited to borrowers who elect to opt in. The Florida Supreme Court's order sets strict standards for servicer participation through an authorized representative and places some modest documentation requirements on foreclosing servicers. Local courts in Florida have been implementing the procedures gradually during 2010, and the pace and quality of implementation has not been uniform throughout the state.

For the most part, these statewide court-initiated programs, unlike those created by state statutes, do not set any standards for what must be considered at mediations or conferences. For example, none of the court-initiated programs require a servicer to disclose a net present value analysis. The Florida Supreme Court's administrative order is perhaps an exception, as it does set documentation requirements for servicers.[96] Apart from this exception, the judicial programs tend to incorporate foreclosure cases into pre-existing alternative dispute resolution models. The programs were generally slow in getting started, and participation rates by homeowners have been low.

Although it did not create a mediation system, the Supreme Court of South Carolina issued an order on May 22, 2009, requiring servicers to show that they engaged in a form of loss mitigation before they proceed with a foreclosure.[97] The court's order required that the servicer certify its compliance with its HAMP obligations in all new foreclosure cases. This certification is a condition to proceeding with foreclosure through the state's judicial process. The supreme court's order does not implement a system to review compliance with this certification requirement. Servicers can satisfy the requirement with a

AOSC09-54, 2009 WL 5227471, at *1 (Fla. Dec. 28, 2009).

92. *See* FLA. R. JUD. ADMIN. 2.215(b)(2).

93. *See Task Force on Residential Mortgage Foreclosure Cases*, FLA. SUP. CT., http://www.floridasupremecourt.org/pub_info/foreclosure.shtml (last visited Sept. 8, 2010).

94. *See In re Final Report*, 2009 WL 5227471, at *1.

95. *See* Duane Marsteller, *Foreclosure Mediation Off to Slow Start*, BRADENTON HERALD, Mar. 31, 2010, *available at* http://www.bradenton.com/2010/03/31/v-print/2170133/foreclosure-mediation-off-to-slow.html.

96. *See In re Final Report*, 2009 WL 5227471, at *8.

97. *See* Mortgage Foreclosures and the Home Affordable Modification Program (HMP), Order No. 2009-05-22-01 (S.C. May 22, 2009), available at http://www.judicial.state.sc.us/courtOrders/displayOrder.cfm?orderNo=2009-05-22-01.

declaration containing a general averment of compliance. Servicers are thus left with considerable discretion to determine their own compliance with the rules of the HAMP program.[98]

VIII. SELECTED CONSTITUTIONAL ISSUES RELEVANT TO CONTEMPORARY STATE AND LOCAL MANDATORY MEDIATION PROGRAMS

The mandatory mediation programs that the states have been initiating since 2008 fit well within the range of borrower protections that can withstand Contracts Clause challenges. The Minnesota Court of Appeals's decision in *Laue v. Production Credit* addressed the basic Contacts Clause issues likely to arise in any similar challenge.[99] As the *Laue* court noted, mediation procedures do not affect the underlying obligation of the mortgage, but fit well within the state's authority to create and modify remedies for default.[100]

Since the *Laue* decision, the general use of mediation in connection with nearly all types of judicial proceedings has become more prevalent. When foreclosure mediation systems are implemented within the existing framework and rules for a court system's mediation program, it will be difficult to raise serious objections to the practice.

The judicial or nonjudicial nature of a state's foreclosure system should make little difference in terms of the constitutional validity of a mediation program. As the Supreme Court noted in *Richmond Mortgage & Loan*, lenders have no constitutionally protected interest in the maintenance of a nonjudicial foreclosure system.[101] State legislatures are free to modify or remove such systems entirely.[102] In their place, states can require lenders to pursue the alternative judicial foreclosure remedies available under the laws of all states. Much of the Depression-era legislation, like the 1986 Minnesota moratorium statute, simply gave borrowers the option to convert a nonjudicial foreclosure to a proceeding that became, in whole or in part, a judicial foreclosure.

Issues related to the validity of mediation programs are more likely to arise in two particular areas. First, mediation systems that require consideration of a particular substantive test as a condition to granting permission to foreclose may face constitutional questions on Contracts Clause or Takings Clause grounds. Second, to the extent that local government entities, rather than state legislatures and courts, create the programs, there may be questions as to the

98. The supreme courts of New Hampshire, Iowa, and Wisconsin have authorized the development of voluntary local court mediation programs for foreclosures. *See supra* note 90 (noting voluntary nature of these states' programs, requiring both parties to opt in to mediation).

99. *See* Laue v. Prod. Credit Ass'n of Blooming Prairie, 390 N.W.2d 823, 826 (Minn. Ct. App. 1986) (addressing issues before court).

100. *See id.* at 829 (recognizing means narrowly tailored to protect public purpose).

101. Richmond Mortg. & Loan Corp. v. Wachovia Bank & Trust Co., 300 U.S. 124, 131 (1937) (determining statute does not interfere with Contract Clause protection).

102. *See Laue*, 390 N.W.2d at 830 (holding application of act within legislature's power).

effect of the separation of powers doctrine and preemption under state law, particularly under state constitutions.

A. Can State and Local Mediation Programs Impose Substantive Obligations on Lenders to Participate in Good Faith and Modify Loans in Appropriate Circumstances?

Since mid-2008, mediation as a means to stem the rampant tide of foreclosures has had a definite appeal for state and local policymakers. Few would argue with the basic principle that it is helpful to have authorized representatives of lenders sit down with borrowers to consider loss mitigation options. However, the new state laws have varied significantly in what they require lenders and servicers to do as part of a mediation. Some state programs, such as those in California and Oregon, rely almost entirely on voluntary compliance by servicers. Other programs have been structured to impose a high degree of transparency upon the servicer's review of loss mitigation options. The more highly-structured programs, such as those in Maine, Nevada, and Vermont, have adopted some common features in order to heighten servicers' accountability. These programs, which operate in both judicial and nonjudicial foreclosure states, rely upon courts to enforce mediation requirements. For example, the courts ultimately enforce requirements for good faith participation. Still, there are certain issues that none of the existing statutes address. For example, none speak directly to the question of whether a court may bar foreclosure if a servicer rejects loss mitigation options that are clearly appropriate for the borrower and that do not substantially impair the investors' recovery under the obligation.

At most, the more venturesome of the mediation statutes mandate reasonable *consideration*, as opposed to *implementation*, of loss mitigation options as a condition to foreclosure. There is already significant precedent for courts to bar foreclosure when lenders failed to consider loss mitigation options that they were required by contract or regulation to consider as alternatives to foreclosure. For example, federally related loan programs, including the Federal Housing Administration (FHA) insured, Rural Housing, and Veterans Administration programs have for many years required participating lenders to consider loss mitigation options before foreclosing. Courts exercising their equitable powers have refused to allow lenders participating in these government-insured programs to foreclose when they had failed to consider the alternatives to foreclosure available under the programs.[103]

103. *See, e.g.*, United States v. Shields, 733 F. Supp. 776, 785 (D. Vt. 1989); Fed. Nat'l Mortg. Ass'n v. Moore, 609 F. Supp. 194, 196-97 (N.D. Ill. 1985); Ghervescu v. Wells Fargo Home Mortg., No. E041809, 2008 WL 660248, at *5 (Cal. Ct. App. Mar. 13, 2008); Wells Fargo Home Mortg., Inc. v. Neal, 922 A.2d 538, 551-53 (Md. 2007); Associated E. Mortg. Co. v. Young, 394 A.2d 899, 907 (N.J. Super. Ct. Ch. Div. 1978); Fed. Nat'l Mortg. Ass'n v. Ricks, 372 N.Y.S.2d 485, 494-96 (Sup. Ct. 1975); Fleet Real Estate Funding Corp. v. Smith, 530 A.2d 919, 923 (Pa. Super. Ct. 1987).

None of the current state foreclosure mediation statutes expressly authorize a court to deny foreclosure relief to a lender who has rejected a loan modification option that was shown through mediation to be affordable for the homeowner and more beneficial to investors than foreclosure. Would such a provision violate the Contracts Clause? This question becomes pertinent today given the emergence of effective tools for evaluating the potential effects of a loan modification in a given case. In 2008, the FDIC released its model loan modification program.[104] The FDIC "mod in a box" program calculates an affordable modified loan and compares the value of this modified loan with the value the lender will receive if it proceeds with foreclosure. An acceptable loan modification under the FDIC model is one that is both affordable to the borrower and allows the lender to recover more than it would receive if it acquired the property through foreclosure. HAMP contracts require participating servicers to implement loan modification for qualifying borrowers when the net present value test shows that loan modification is a better option than foreclosure for investors.

B. Does a State Law that Denies Foreclosure to a Lender Who Rejects a Reasonable Loan Modification Violate the Contracts Clause?

The basic definition of a loan modification is an agreement that permanently changes one or more terms of an original obligation, such as a change of the interest rate or repayment term. A modification may include the lender's forbearance or waiver of some portion of the principal. The agreement is typically made in order to resolve a default or to settle litigation between the parties.

In holding that the Minnesota moratorium statute did not violate the Contracts Clause, the *Blaisdell* Court expressly held that the statute did not "impair the integrity of the mortgage indebtedness."[105] In fact, the Court carefully noted that the operation of the state law did not alter the interest rate, impair the lender's right to claim a deficiency, or affect the outcome of the foreclosure sale other than by extending the time to redeem.

A state law that limits a lender's discretion to reject a reasonable loan modification initially appears to be precisely the type of law that a court looking to *Blaisdell* for guidance would feel compelled to invalidate. However, this type of legislation must be placed in its contemporary context. A loan modification program such as the one developed by the FDIC in 2008 was not a factor to be considered in past reviews of state foreclosure laws under the Contracts Clause. Stakeholders can now use a sophisticated computer model to evaluate the actual costs and benefits from foreclosure for a particular mortgage

104. *See IndyMac Loan Modification Program—"Mod in a Box,"* FDIC, http://www.fdic.gov/consumers/loans/loanmod/loanmodguide.html (last updated Nov. 29, 2010).

105. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 425 (1934).

holder and a particular type of loan. Essentially, the tool places a reliable monetary estimate on the degree of impairment that an affordable loan modification will impose on the underlying obligation and calls for modification only when accepting the impairment is more beneficial for investors than foreclosure. The federal government has incorporated this type of net present value test into its mandatory guidelines for HAMP—the government's major effort to combat the foreclosure crisis.

As noted above, the loan modification remedy is particularly appropriate in view of the needs of borrowers, servicers, and mortgage holders in the current foreclosure crisis. Unlike the situation during the Great Depression, lender activities, such as widespread extensions of credit to borrowers unable to pay and grants of credit based on inflated appraisals, have been major contributing factors to the current crisis. Loan modifications address the issue of a borrower's ability to pay—a factor that may have been given scant consideration at loan origination. The modifications may also address the need to adjust property valuations and loan principal balances to reflect current market conditions.

A state's current preference for nonjudicial over judicial foreclosures should not affect the validity of a statute authorizing the courts to evaluate a lender's loss mitigation record. As the Supreme Court noted in *Richmond Mortgage & Loan*, "[t]he particular remedy existing at the date of the contract may be altogether abrogated if another equally effective for the enforcement of the obligation remains or is substituted for the one taken away."[106] Thus, states may always modify statutorily created nonjudicial foreclosure systems to divert foreclosures to a judicial system without implicating any constitutional concerns.

The Supreme Court's treatment of states' anti-deficiency laws under a Contracts Clause analysis during the 1930s is instructive in anticipating how a court might analyze contract impairment claims related to a state law requirement for consideration of loan modifications. In *Richmond Mortgage & Loan*, the Court held that North Carolina's anti-deficiency statute did not violate the Contracts Clause because the state preserved the lender's right to pursue a deficiency claim though judicial foreclosure.[107] However, the Court's next two considerations of anti-deficiency laws had more significant implications. In *Honeyman v. Jacobs*[108] and *Gelfert v. National City Bank of New York*,[109] the Court reviewed New York's anti-deficiency law. New York, unlike North Carolina, did not allow lenders an alternative method to pursue deficiency claims. The New York law applied in judicial foreclosures and the

106. *Richmond Mortg. & Loan*, 300 U.S. at 128-29.
107. *See* Richmond Mortg. & Loan Corp. v. Wachovia Bank & Trust Co., 300 U.S. 124, 131 (1937).
108. 306 U.S. 539 (1939).
109. 313 U.S. 221 (1941).

state had no other applicable foreclosure system. Therefore, the New York laws subjected all lenders' deficiency claims to a significant reduction based on the statute's imposition of the fair market value measure as the standard to define the amount of the deficiency. Unlike the Minnesota statute upheld in *Blaisdell*, which extended a post-sale redemption period while compensating the lender for the delay, the New York anti-deficiency statute authorized a fundamental and permanent diminution of the lender's underlying contract claim. Under the mortgage contracts they had prepared with New York properties as security, lenders had a right to sue borrowers for the full amount of any deficiency—the difference between the foreclosure sale price and the debt. The subsequently enacted New York statute unquestionably took away this right to the extent of a property's current market value and did not replace this lost value with anything else.

In *Gelfert*, the Court noted that it had previously held in *Honeyman* that the Contracts Clause protected the lender's right to "no more than payment in full."[110] However, what constituted "payment in full" did not necessarily equal the most advantageous recovery the lender could obtain through foreclosure. Rather, in the context of mortgage foreclosures, the payment to which a lender was entitled had much to do with what the courts perceived as fair in a given case. Given this history of judicial limitations imposed on creditors' claims through application of equitable standards of fairness, the *Gelfert* Court found it appropriate that the New York legislature had set general statutory guidelines incorporating these judicial principles. As the *Gelfert* Court stated:

> Mortgagees are constitutionally entitled to no more than payment in full. They cannot be heard to complain on constitutional grounds if the legislature takes steps to see to it that they get no more than that. As we have seen, equity will intervene in individual cases where it is palpably apparent that gross unfairness is imminent. That is the law in New York. But there is no constitutional reason why in lieu of the more restricted control by a court of equity the legislature cannot substitute a uniform comprehensive rule designed to reduce or to avoid in the run of cases the chance that the mortgagee will be paid more than once.[111]

Under New York's prior law, the lender had the right to resell a property it foreclosed upon and purchased at sale, typically recovering a price much greater than the auction bid. At the same time, the lender could pursue the borrower for the full difference between the foreclosure sale price and the full indebtedness. The lenders viewed the right to pursue a full recovery as an essential aspect of their contracts. The *Gelfert* Court disagreed: "[t]o hold that

110. *See id.* at 233-34 (citing *Honeyman*, 306 U.S. 539).
111. *See id.* at 234 (internal citations omitted).

mortgagees are entitled under the contract clause to retain the advantages of a forced sale would be to dignify into a constitutionally protected property right their chance to get more than the amount of their contracts."[112] In the Court's view, retaining the advantages of a forced sale—i.e. a full deficiency judgment—was getting more than the amount fairly owed under the contract. This was another way of saying that in certain circumstances, a lender's claim for strictly what the contract allowed was inequitable: a court of equity would not allow such a recovery, and therefore the state legislature could impose similar equitable limits in foreclosures.

The Supreme Court's Depression-era deficiency decisions refer repeatedly to the traditional role of courts of equity in foreclosures.[113] The *Gelfert* Court summed up this tradition as follows:

> We mention these matters here because they indicate that for about two centuries there has been a rather continuous effort either through general rule or by appeal to the chancellor in specific cases to prevent the machinery of judicial sales from becoming an instrument of oppression. And so far as mortgage foreclosures are concerned numerous devices have been employed to safeguard mortgagors from sales which will or may result in mortgagees collecting more than their due.[114]

Turning to the loan modification issue, several basic questions are likely to arise: (1) is the lender who refuses the reasonable loan modification developed in the course of mediation similar to the lender who insisted on the full deficiency claim?; (2) are both seeking something more than a court of equity would consider "payment in full"?; (3) should the creditor's monetary recovery be limited by consideration of the value of the property?; and (4) is the pursuit of a demonstrably unwise financial option a constitutionally protected property right? The *Honeyman* and *Gelfert* decisions support the position that courts in foreclosure actions may enforce reasonable limits on recovery in such cases. If courts may do so as part of their traditional role, state legislatures may draft laws that incorporate these standards as well.[115]

C. Other Constitutional Issues: The Takings Clause

Lenders may argue that state legislation that limits foreclosure when a lender

112. *See id.*

113. *See Gelfert*, 313 U.S. at 232; *Honeyman*, 306 U.S. at 544; Richmond Mortg. & Loan Corp. v. Wachovia Bank & Trust Co., 300 U.S. 124, 129 (1937).

114. 313 U.S. at 232-33.

115. For servicers participating in the HAMP program, some more specific questions will arise. First, may a court bar foreclosure where the servicer did not comply with its contractual obligation to review a borrower in foreclosure for HAMP? Second, may a court bar foreclosure where the borrower was reviewed and found eligible for HAMP, yet the servicer insists on foreclosing? The answer to both questions should be yes.

unreasonably refuses to modify a loan contravenes the Takings Clause of the Fifth Amendment.[116] The Takings Clause most often comes into play when a governmental entity takes physical possession of property for some public purpose.[117] However, state action that falls short of an outright physical taking and instead places significant limits upon an owner's use of property may fall within the scope of the Takings Clause's scrutiny of "regulatory" takings.[118] In assessing the propriety of a regulatory impairment under the Takings Clause, courts look at two factors: (1) the degree to which the governmental action interferes with "distinct investment-backed expectations" of the owner, and (2) the character of the governmental action, including the purpose served.[119] Like the rule under a Contracts Clause analysis, a standard of reasonableness applies: the goal of the state regulation and the regulatory burdens imposed to meet that goal must be reasonable.

A loan modification model, such as the one developed for the FDIC and Treasury's HAMP program, authorizes partial forbearance, when necessary, of the outstanding loan principal to make the borrower's loan repayment affordable.[120] Under this forbearance, the secured debt is bifurcated into an interest-bearing and a non-interest-bearing portion. The forborne principal does not bear interest and is payable as a balloon when the property is sold or refinanced. This feature should preclude any serious challenge under the Takings Clause to use of the model's results as a factor in limiting foreclosures. In *Wright v. Vinton Branch of Mountain Trust Bank*,[121] the Supreme Court held that two provisions of a recently enacted bankruptcy statute allowing debtors to modify mortgages saved the law from invalidation as a violation of the Takings Clause. The mitigating features were that the statute did not destroy the mortgagee's lien—although it reduced the lien to the value of the property—and that the mortgagee retained the right to pursue a foreclosure sale if the borrower defaulted on the modified obligation. The Court had recently struck down a similar bankruptcy statute that it viewed as lacking these creditor protections.[122] Under the FDIC and HAMP modification model, bifurcation of the loan principal into an interest-bearing portion and a deferred non-

116. *See* U.S. CONST. amend. V. "[N]or shall private property be taken for public use, without just compensation." *Id.* The Takings Clause of the Fifth Amendment is made applicable to the states through the Fourteenth Amendment. *See* U.S. CONST. amend. XIV.

117. *See* Kelo v. City of New London, 545 U.S. 469, 488-89 (2005) (holding municipality's acquisition of private property for planned community redevelopment program permissible under Takings Clause); *see also* Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1016-17 (1992) (recognizing deprivation of all economically viable use of property owner's land as unconstitutional taking).

118. *See* Brown v. Legal Found. of Wash., 538 U.S. 216, 233 (2003) (noting distinction between analytical standards for regulatory as opposed to physical takings); Palazzolo v. Rhode Island, 533 U.S. 606, 617 (2001).

119. Penn Cent. Transp. Co. v. City of New York, 438 U.S. 104, 124-25 (1978); *see also Palazzolo*, 533 U.S. at 633-34 (O'Connor, J., concurring).

120. *See* MAKING HOME AFFORDABLE PROGRAM, *supra* note 80, at 41-42.

121. 300 U.S. 440 (1937).

122. *See* Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555 (1935).

amortizing portion allows the mortgagee to gain the benefit of later appreciation of the property. The mortgagee's essential property interest therefore remains intact, precluding a claim that the modification destroys a lien. In addition, the mortgage holder may always foreclose if the borrower fails to make payments after the loan modification.

Takings Clause claims have been raised along with Contract Clause challenges in a number of areas involving state and local regulation of property, including rent control. Rent control laws impose significant limits on the contract rights of property owners. They not only thwart owners' expectations of collecting full market rents on their properties, but in many cases also limit owners' rights to recover possession of their properties from existing tenants by terminating leases at the end of their scheduled terms. For example, a rent control ordinance may preclude landlords from terminating a lease or taking a rental property off the market when the result could be an attempt to rent the property to a new tenant at a higher rent. State laws and local ordinances restricting conversion of rental properties to condominiums have come under similar Takings Clause challenges.[123] Rent control and use conversion laws have an effect on property rights similar to foreclosure restrictions. Both can cause delays in recovering property and a permanent denial of the full economic benefit of the property, and thus, it is useful to consider how these types of laws have fared under constitutional Takings Clause challenges.

The United States Supreme Court rejected Takings Clause and Contracts Clause challenges to post-World War I rent control ordinances of New York City and the District of Columbia in three significant decisions.[124] In those decisions, the Court found the controls on rents and evictions to be justified by the acute post-war housing shortage. When the Minnesota legislature drafted its mortgage moratorium law in 1933, the drafters modeled their statute after the New York's post-World War I rent control laws in hopes of warding off the expected constitutional challenges.[125] In its *Blaisdell* decision sustaining the Minnesota statute, the Supreme Court referred to the previous rent control cases as clear precedent in support of the expansive exercise of the state's emergency police powers to restrict the literal enforcement of private parties' contract rights.[126]

More recently, the Supreme Court has rejected challenges seeking to overturn local rent control laws based on a number of constitutional grounds, including the Takings Clause.[127] Lower federal courts and state appellate

123. *See* Griffin Dev. Co. v. City of Oxnard, 703 P.2d 339, 340-41 (Cal. 1985).

124. *See* Edgar A. Levy Leasing Co. v. Siegel, 258 U.S. 242, 256 (1922); Marcus Brown Holding Co. v. Feldman, 256 U.S. 170, 198-99 (1921); Block v. Hirsh, 256 U.S. 135, 158 (1921).

125. *See* Prosser, *supra* note 2, at 359-60.

126. *See* Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 440-41 (1934).

127. *See* Yee v. City of Escondido, 503 U.S. 519, 539 (1992); Pennell v. City of San Jose, 485 U.S. 1, 9-10 (1988).

courts have for the most part upheld rent control laws and similar landlord-tenant regulations against property owners' claims that the laws functioned as confiscatory takings of their property rights.[128] Generally, courts have allowed governmental bodies flexibility in setting formulas for a fair return on the property owners' investment.[129] In a few instances, courts invalidated these laws as confiscatory, overly burdensome, or unreasonable based on particular procedures and formulas the laws used for calculating fair returns on investment.[130] Loan modifications using net present value calculations, as the FDIC model does, are well designed to demonstrate to investors the fairness of the restructured obligation. Requiring a servicer to implement a HAMP loan modification when appropriate under the program guidelines does no more than enforce the terms of the contracts the servicers have signed.

IX. STATE CONSTITUTIONAL ISSUES RELATED TO MANDATORY MEDIATION PROGRAMS

A. Introduction

There is no question that a state can enact laws imposing substantial control over a lender's exercise of mortgage foreclosure remedies. A state can require mediation as a precondition to a lender's exercise of a right to foreclose, just as it can require mediation before allowing any creditor to exercise any other contractual or property rights. It is well settled that in an economic crisis or any other emergency, states can order delays of the exercise of foreclosure remedies under their police power.

In the context of the current foreclosure crisis, state and local governments, as well as the courts, are again fashioning much needed protections to assist homeowners facing loss of their homes through foreclosure. The Depression-era rulings such as *Blaisdell* still provide the underlying constitutional support for these exercises of the states' police power.

Yet, while *Blaisdell* continues to provide a rebuttal to many Contracts Clause challenges, some innovative local responses to the crisis are raising novel legal questions, questions that extend well beyond application of the

128. *See* Chi. Bd. of Realtors, Inc. v. City of Chi., 819 F.2d 732, 738-40 (7th Cir. 1987) (holding landlord ordinance regulating charges and other obligations did not violate constitutional provisions); Troy Ltd. v. Renna, 727 F.2d 287 (3d Cir. 1984) (upholding limits on lease termination in light of legislative deference); Help Hoboken Hous. v. City of Hoboken, 650 F. Supp. 793, 797-99 (D.N.J. 1986) (sustaining ordinance imposing penalties for not renting properties); *Griffin Dev. Co.*, 703 P.2d at 341-45 (sustaining ordinance restricting conversion of rental units to condominiums).

129. *See, e.g.*, San Marcos Mobilehome Park Owners' Ass'n v. City of San Marcos, 238 Cal. Rptr. 290, 293 (Ct. App. 1987); Hutton Park Gardens v. Town Council of Town of W. Orange, 350 A.2d 1, 15 (N.J. 1975).

130. *See* Hall v. City of Santa Barbara, 797 F.2d 1493, 1502 (9th Cir. 1986); Ross v. City of Berkeley, 655 F. Supp. 820, 835-36 (N.D. Cal. 1987).

Contracts Clause. For example, is ordering mediation of residential foreclosures a proper function of the executive, the legislative, or the judicial branch of state government? Where foreclosures in a particular state proceed through privately conducted nonjudicial sales, which branches of state government have authority to set conditions upon lenders' use of these procedures? And what about the power of local government in this area? Can a mayor, a county commissioner, a city council, a president judge of a county court, or a county sheriff implement a moratorium or mediation program and stay foreclosure sales pending mediation? Can local officials enforce such a program?

B. Regulating Foreclosures at the State Level—Separation of Powers Issues

State constitutions incorporate their own separation of powers principles similar to those of the Federal Constitution. Under these standards, the judicial branch of each state's government exercises primary authority over matters related to court rules and the scheduling of judicial events. Typically, the supreme court of a state exercises rulemaking authority over the lower courts of the state's judicial system. For example, state supreme courts often promulgate rules detailing when mediation will be required for certain categories of cases. Many state courts have adopted procedures modeled after Rule 16 of the Federal Rules of Civil Procedure, which mandates mediation of most civil cases filed in the federal court system.

In states with judicial foreclosure systems, legislatures enacting laws related to foreclosures must pay attention to the separation of powers doctrine. For example, if a state supreme court in a judicial foreclosure state has promulgated a rule that excludes all foreclosure cases from mandatory mediation, a bill that proposes to require mediation in all judicial foreclosures might tread impermissibly into an area over which the judiciary has exclusive authority.

Case law on separation of powers issues related to mediation and judicial proceedings has produced mixed results. For example, the Tennessee legislature recently enacted a statute that mandated mediation in all workers compensation cases.[131] Claimants challenged the statute on the ground that it was a legislative intrusion into exclusively judicial matters. However, the state supreme court found no separation of powers problem with the statute because it left intact all judicial remedies related to workers compensation and did no more than set up a procedure to supplement those remedies.[132]

A state constitutional provision that vests "exclusive" authority over judicial matters with the courts does not necessarily preclude the legislature from establishing quasi-judicial, administrative procedures that must be exhausted

131. *See* TENN. CODE ANN. §§ 50-6-203(a), -225(a)(1) (2005).

132. *See* Lynch v. City of Jellico, 205 S.W.3d 384, 393 (Tenn. 2006).

before a potential litigant may proceed to court.[133] The legislature can enlarge upon what are otherwise exclusive judicial functions without violating the separation of powers doctrine.[134] For example, a number of state legislatures recently enacted statutes requiring litigants to obtain a "certificate of merit" from an expert before filing certain medical malpractice actions in state courts. Appellate courts have generally held that these statutes supplement expert disclosure requirements under existing court rules and do not conflict with them.[135]

While there have not been any significant decisions on separation of powers issues related to legislative modification of judicial foreclosure procedures, the past treatment of landlord and tenant eviction cases presents some useful analogies. Courts will invalidate state legislative enactments related to evictions to the extent that they conflict with specific court rules governing the same subject. However, the fate of the enactment will depend on the degree of imposition it creates. For example, a New York court declined to strike down a state statute directing the courts' authority to stay evictions or continue eviction hearings.[136] Similarly, a Florida court held that a state statute requiring commercial borrowers to pay interest during foreclosure proceedings affected both substantive and procedural rights of parties, and therefore, did not impinge upon areas of exclusive judicial concern.[137]

Some general principles apply to these separation of powers rulings. To the extent that a legislative enactment merely supplements rather than directly conflicts with an established court rule, the less likely it will be vulnerable to challenges on separation of powers grounds. The more that legislation conflicts with specific timeframes and detailed procedural rules already contained in court rules, the greater the likelihood of conflict.

Adding mediation requirements to nonjudicial foreclosures presents fewer separation of powers concerns than it does for judicial foreclosures. Because courts do not play a significant role in conducting nonjudicial foreclosures, the potential for conflicts with specific court rules is remote. Mediation legislation related to judicial foreclosures, however, may raise possible separation of powers issues. Again, the terms of state constitutions vary in the degree to which the legislature is allowed to encroach into the creation of court rules and procedures. Some states specifically allow the legislature to supersede or repeal formally promulgated court rules by legislation.[138] To date, the state

133. *See* Lynn v. Simmons, 95 P.3d 99, 103 (Kan. Ct. App. 2003).

134. *See* Pools By Murphy & Sons, Inc. v. Dep't of Consumer Protection, 841 A.2d 292, 301-02 (Conn. Super. Ct. 2003) (upholding legislation creating state panel to assess administrative penalties in consumer protection matters).

135. *See* Bertelson v. Sacks Tierney, P.A., 60 P.3d 703, 708 (Ariz. Ct. App. 2002).

136. *See* Lang v. Pataki, 707 N.Y.S.2d 90 (App. Div. 2000).

137. *See* Caple v. Tuttle's Design-Build, Inc., 753 So. 2d 49, 54 (Fla. 2000).

138. *See* Taylor v. State, 969 So. 2d 583, 584 (Fla. Dist. Ct. App. 2007) (recognizing state constitution expressly allows legislation to repeal court rule by two-thirds vote).

legislative initiatives have operated harmoniously with judicial procedures, and there have been no separation of powers challenges to the recently enacted statutes.

X. LOCAL REGULATION OF MORTGAGE FORECLOSURES

A. Authority of Local Courts to Stay Judicial Foreclosures and Require Mediation

As discussed above, state supreme courts typically have authority to promulgate rules that govern local court proceedings. A state supreme court may also delegate authority to local courts to fashion rules for adjudicating particular classes of cases. The recent actions of various state supreme courts authorizing local foreclosure moratorium programs in connection with judicial foreclosures fit within this standard framework of delegated authority from a state supreme court to local county or district courts.

As the current foreclosure crisis worsened, not all local courts waited for an express directive from a supreme court before adopting their own local procedures to respond to the crisis. In April 2008, after the Philadelphia sheriff initially exercised his own scheduling discretion to stay monthly foreclosure sales in the city, the president judge and administrative judge of the Philadelphia Common Pleas Court promulgated a local court regulation that established a "Residential Mortgage Foreclosure Diversion Pilot Program."[139] This program mandated mediation sessions prior to allowing a lender to proceed with a sheriff's sale of a home.

Under the Pennsylvania Rules of Civil Procedure, as promulgated by the Pennsylvania Supreme Court, the chief administrative judge of a county common pleas court has authority to "supervise the judicial business of the court" and may "promulgate all administrative rules and regulations." [140] This rule gave the chief judge of the Philadelphia court ample authority to modify the scheduling of foreclosure cases. In January 2009, the president judge of the Allegheny County (Pittsburgh) court began to implement a similar residential mortgage foreclosure mediation system.[141]

In 2008 and 2009, several Florida judicial circuit courts acted in a similar

139. Residential Mortgage Foreclosure Diversion Pilot Program, Joint Gen. Ct. Reg. No. 2008-01 (Pa. Ct. of Com. Pl. Phila. Cnty. Apr. 16, 2008), *available at* http://www.courts.phila.gov/pdf/regs/2008/cpjgcr-2008-01.pdf.

140. 42 PA. CONS. STAT. § 325(e)(1) (2004); *see also* PA. R. CIV. P. 3121(b)(2), 3183(b)(2) (allowing courts to stay execution of judgments for money and foreclosure on general equitable grounds).

141. *See Foreclosure Mediation Encouraged for County Courts*, PA. LEGAL AID NETWORK, http://www.palegalaid.net/news/plan-e-news/foreclosure-mediation-encouraged-county-courts (last visited Sept. 8, 2010) (listing all Pennsylvania counties with foreclosure mediation programs). Other Pennsylvania counties that adopted foreclosure mediation or diversion programs during 2009 and 2010, using their general rulemaking authority, include: Bucks, Butler, Fayette, Lackawanna, Northampton, and Somerset counties. *Id.*

manner. Under Florida Rule of Judicial Administration 2.215(b)(2), the chief judge of a circuit court may issue administrative orders related to court procedures within that circuit.[142] These administrative orders can be issued at the discretion of the local chief judge, with an aggrieved party having the right to seek review of the order by the state supreme court. Several Florida circuit courts implemented foreclosure mediation programs under this authority during 2008 and 2009. As discussed above, however, the Florida Supreme Court eventually issued its own order of general statewide application for foreclosure mediation in December 2009. The Florida Supreme Court's order seeks a uniform statewide system incorporating many of the features of these earlier local programs. In Kentucky,[143] New Mexico,[144] Illinois,[145] and Hawaii,[146] local programs developed while serving a single county or judicial district.

Not all local administrative judges in judicial foreclosure states have the same delegated authority to create foreclosure mediation programs. The scope of the administrative judges' authority depends upon the language of the state court rules and the discretion of local judges.

B. Actions By Other Local Officials: Mayors, City Councils, County Commissioners, Sheriffs, and Clerks

1. Local Regulation of Judicial Foreclosures—Potential Problems Related to the Separation of Powers Doctrine

In judicial foreclosure states, separation of powers issues may arise when local officials who are not part of the judiciary attempt to regulate mortgage foreclosure procedures. The state's supreme court may possess the exclusive rulemaking power related to judicial foreclosures. Thus, actions by local executive and legislative officials may run afoul of this authority, particularly if those actions create new local procedures that conflict with duly promulgated state court rules. Local officials may encounter the same separation of powers obstacles state legislators face when they attempt to assert extensive control over established judicial procedures.

To the extent that judicial officials with direct or delegated authority promulgate rules that set timeframes and procedures for judicial foreclosures,

142. *See* FLA. R. JUD. ADMIN. 2.215(b)(2).

143. Order (Ky. Cir. Ct. 30th Mar. 30, 2009), *available at* http://s98001.gridserver.com/images/pdf/foreclosure_mortgage/foreclosure_med_prog_by_state/kentucky_admin_order.pdf.

144. *In re* a Foreclosure Mediation ADR Option, Admin. Order No. 2009-00001 (N.M. Dist. Ct. 1st Apr. 30, 2009), *available at* http://www.firstdistrictcourt.com/Forms/pdf/Admin%20Order%203.pdf.

145. About the Mortgage Foreclosure Mediation Program, CIRCUIT CT. OF COOK COUNTY, http://cookcountyforeclosurehelp.org/about (last visited Sept. 8, 2010) (noting establishment of foreclosure mediation program in April 2010 for Cook County, Illinois, which includes Chicago).

146. Press Release, Haw. State Judiciary, Big Island Homeowners May Mediate Foreclosure Action (Jan. 20, 2010), http://www.courts.state.hi.us/news_and_reports/press_releases/2010/01/foreclosure_mediation.html.

local officials with no delegated judicial authority will not have the power to change these established rules.[147] The basic principle is that legislative bodies can enact the policies that courts must apply, but they may not mandate the procedures the courts must use to apply the policies. Municipal governments contemplating the creation of mediation systems that set conditions for access to existing statewide judicial proceedings will have to tread carefully so as not to upset the balance of power favoring judicial control over court proceedings.

2. The Role of Local Government/Officials in Conditioning Foreclosure upon Participation in Mediation

a. Municipal Authority Under Home Rule Charters

As a general principle, local governments—cities, counties, townships—do not have inherent power to enact laws. Traditionally, municipalities were treated as creatures of the state, exercising only the constitutional and statutory powers granted to them by a state. Home rule charters, however, authorize a different approach to local government sovereignty. Many state constitutions allow local governments to adopt charters providing them greater autonomy to create laws applicable within their boundaries. Adopting a home rule charter typically grants a local government the power to enact laws to the full extent possible for a state legislature.[148] There are two basic limitations on home rule powers. First, the local government cannot enact laws that conflict with a specific state statute or provisions of the state constitution. Second, the local law can only apply within the geographic boundary of the local entity.[149]

b. Preemption by the State—Limits on Home Rule Power

Enactments under home rule charters are presumed to be valid and the party alleging a conflict with state law has the burden to show a conflict. State preemption of laws passed under local home rule authority is not favored. Generally, in order for preemption to occur, there must be an actual conflict between a state law and a local law. State legislatures must expressly preempt a particular field in order to preclude local enactments in the same area. Because local governments have broad authority to exercise their police power

147. *See, e.g.*, Vill. of Glenview v. Zwick, 826 N.E.2d 1171, 1180-81 (Ill. App. Ct. 2005) (invalidating local ordinance allowing attorney fee-shifting litigation against municipality as contrary to statewide judicial practice); Molitor v. City of Cedar Rapids, 360 N.W.2d 568, 570 (Iowa 1985) (holding city lacked authority to provide for method of appeal from its housing board to courts); *In re* Fifth Ave. Office Ctr. Co. v. City of Mount Vernon, 680 N.E.2d 590, 591-92 (N.Y. 1997) (holding municipality may not restrict access to judicial review of tax assessments authorized under statewide procedure); City of Spokane v. J-R Distribs., Inc., 585 P.2d 784, 788 (Wash. 1978) (en banc) (holding city cannot enact ordinance mandating superior courts to follow certain procedures in nuisance abatement cases).

148. *See* EUGENE MCQUILLIN, THE LAW OF MUNICIPAL CORPORATIONS § 10.15, at 453 (3d ed. rev. 2006).

149. *See id.* at 459.

under home rule charters, preemption of a local exercise of the police power is not to be implied lightly.

There is little judicial precedent construing the extent of local government power to regulate foreclosures. In a somewhat related context, the authority of local government to enact ordinances regulating predatory lending practices recently produced a spate of decisions from the courts.[150] The Federal Home Ownership and Equity Protection Act (HOEPA) is a set of amendments to the Truth in Lending Act requiring certain disclosures and prohibiting oppressive terms in home-secured loans. After the enactment of HOEPA, many state legislatures enacted "mini-HOEPA" statutes in order to regulate predatory lending practices. Typically, these state statutes were more restrictive in regulating lender practices than the Federal HOEPA.[151]

Contemporaneously with the enactment of these state HOEPA laws, municipalities in New York, California, and Ohio enacted their own ordinances regulating predatory lending.[152] These ordinances set stricter interest rate limits, regulated other loan terms—such as prepayment penalties—more severely than the state statutes, and required counseling as a condition to granting of high cost loans. The Oakland, California, ordinance abrogated the holder-in-due-course rule for assignees of lenders.[153] The New York City ordinance prohibited the city from doing business with entities involved in predatory lending. The mortgage-lending industry mounted immediate legal challenges to the ordinances of New York City, Oakland, and three Ohio cities, Cleveland, Dayton, and Toledo. Ultimately, the industry prevailed in striking down all the local ordinances on state law preemption grounds.[154]

The decisions in these cases were not as monolithic as the ultimate results suggest. Intermediate appellate courts in California and Ohio upheld the validity of the Oakland, Cleveland, and Toledo ordinances against the preemption challenges. The California Supreme Court found preemption by a

150. *See, e.g.*, Am. Fin. Servs. Ass'n v. City of Oakland, 104 P.3d 813, 823 (Cal. 2005) (concluding Oakland city ordinance preempted by state law); Mayor of New York v. Council of New York, 780 N.Y.S.2d 266, 274 (Sup. Ct. 2004) (invalidating New York City ordinance due to preemption by state law); Am. Fin. Servs. Ass'n v. City of Cleveland, 858 N.E.2d 776, 786 (Ohio 2006) (holding Cleveland ordinance regulating predatory lending preempted by state law).

151. *See* Home Ownership and Equity Protection Act of 1994 (HOEPA), 15 U.S.C. § 1639 (2006) (amending 15 U.S.C. § 1639 (1994)).

152. *See., e.g.*, OAKLAND, CAL., MUN. CODE ch. 5.33 (2001); NEW YORK, N.Y., LOCAL LAWS No. 36 (2002); DAYTON, OHIO, CODE §§ 112.40-.44 (2001).

153. *See City of Oakland*, 104 P.3d at 819.

154. *See id.* at 820; *Mayor of New York*, 780 N.Y.S.2d at 275-76; Am. Fin. Servs. Ass'n v. City of Toledo, 859 N.E.2d 923 (Ohio 2006) (reversing appellate court's decision upholding city ordinance, under reasoning of *City of Cleveland*); *City of Cleveland*, 858 N.E.2d at 790; *see also* Kimm Tynan, Note, *Pennsylvania Welcomes Predatory Lenders: Pennsylvania's Act 55 Preempts Philadelphia's Tough Ordinance but Provides Little Protection for Vulnerable Borrowers*, 34 RUTGERS L.J. 837, 879-80 (2003) (discussing lending industry's successful use of state legislation to override local initiative). *See generally*, Jonathan L. Entin & Shadya Y. Yazback, *City Governments and Predatory Lending*, 34 FORDHAM URB. L.J. 757 (2007).

mere four-to-three margin, while two justices dissented in the Ohio Supreme Court's ruling.[155] Thus, even on the issue of preemption related to state predatory lending statutes, the law cannot be considered settled for other jurisdictions and different preemption issues.

These judicial discussions of state preemption issues in the municipal predatory lending ordinance cases suggest ways to frame preemption arguments over local foreclosure and mediation ordinances.[156] In California, Ohio, and New York, the municipalities acted to regulate predatory lending locally at the same time the state legislature was enacting statewide predatory lending regulation on the same subject.[157] Express declarations in each of the statewide mini-HOEPA statutes strongly indicated a legislative intent for statewide preemption of the regulation of predatory lending. The Ohio statute authorized the state to:

> *solely* . . . regulate the business of originating, granting, servicing, and collecting loans and other forms of credit in the state and the manner in which any such business is conducted . . . in lieu of all other regulation of such activities by any municipal corporation or other political subdivision.[158]

The Ohio Supreme Court held that the state legislature acted in accordance with this authority in enacting the state mini-HOEPA statute.[159] The general New York state banking law at issue also provided for "uniform regulation of the residential mortgage lending process."[160]

The Ohio Supreme Court, in *American Financial Services Ass'n v. City of Cleveland*,[161] considered the state's collection of general statutes regulating the mortgage industry to be laws occupying the field of regulation of mortgage lending.[162] Under the majority's view, however, the express intent of the legislature to preempt local laws would not be sufficient to strike down a local ordinance unless the local ordinance actually conflicted with the general state statute.[163] Here, the court found that the Cleveland ordinance prohibited forms

155. *See City of Oakland*, 104 P.3d at 820; *see also City of Cleveland*, 858 N.E.2d at 779.

156. *See* Am. Fin. Servs. Ass'n v. City of Oakland, 104 P.3d 813, 815 (Cal. 2005); *see also* Mayor of New York v. Council of New York, 780 N.Y.S.2d 266, 274 (Sup. Ct. 2004); Am. Fin. Servs. Ass'n v. City of Cleveland, 858 N.E.2d 776, 779 (Ohio 2006).

157. *See City of Oakland*, 104 P.3d at 820; *see also Mayor of New York*, 780 N.Y.S.2d at 274; *City of Cleveland*, 858 N.E.2d at 788.

158. OHIO REV. CODE. ANN. § 1.63(A) (West 2004) (emphasis added).

159. *See City of Cleveland*, 858 N.E.2d at 785 (declaring local ordinances prohibiting conduct authorized by state unconstitutional).

160. *Mayor of New York*, 780 N.Y.S.2d at 273-74 (quoting N.Y. BANKING LAW § 589 (McKinney 2008)).

161. 858 N.E.2d 776 (Ohio 2006).

162. *See id.* at 784.

163. *Id.* at 785 (focusing on actual conflict with state statute). The concurring opinion would have found such a declaration of intent to preempt sufficient to block the local law and considered Ohio in line with seven other states in which state legislatures had preempted the field of mortgage lending regulation by general

of predatory lending that were permitted under the state statute, and this difference in treatment amounted to a conflict. The dissenting justices rejected the contention that more stringent local regulation intended to achieve the same goals as the state legislation amounted to a conflict. In addition, according to the dissent, the state lacked authority under its constitution to prohibit local government from regulating an area of such vital local importance as predatory lending.[164]

In *American Financial Services Ass'n v. City of Oakland*,[165] a majority of the California Supreme Court found preemption by implication.[166] That majority inferred the state's intent to regulate predatory lending from its historical role in regulating mortgage lending. The dissent strongly disagreed with the majority's finding of implied preemption and adhered to the well-established rule that silence on the issue of preemption in state legislation should not be ignored. With respect to the California mini-HOEPA statute, the legislature had actually considered, but declined to adopt, a provision preempting local initiatives.[167] The dissenters went on to describe how, regardless of the lack of local government involvement in past mortgage lending regulation, there was sound rationale for this present involvement.[168]

> Thus, despite the circumstance that mortgage regulation historically has occurred at the state rather than the local level, we must recognize the concerns implicated by the recent rapid escalation of predatory lending. In view of the documented evidence that predatory lending is especially pervasive in low-income and minority neighborhoods, it is beyond dispute that Oakland and other similarly situated localities have a more significant interest in regulating subprime lending than localities that, because of demographics and composition, are not targeted in similar ways. Local regulation thus is not only constitutionally valid, but practically vital to the affected communities. Although predatory lending certainly is a matter of statewide concern, the specific interests of the communities most affected by the banned practices make the regulation of this field particularly amenable to local variations.[169]

Local initiatives directed at mandatory mediation and loan modifications

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statutes. *See id.* at 789 (O'Connor, J., concurring). In the concurring opinion's view, these seven states were Arizona, California, Connecticut, North Carolina, Pennsylvania, Texas, and Washington. *Id.*

164. *See id.* at 795-96 (Pfeifer, J., dissenting) (noting problems with predatory lending in Cleveland). The dissent noted that Cleveland is "the poorest large city in the United States" and observed that "[p]redatory lenders prey on the poor, and Cleveland is thus especially prone to predatory lending and its inevitable aftermath. Is it appropriate for the General Assembly to restrict the ability of municipalities to respond to the problems attendant to poverty?" *Id.* at 795.

165. 104 P.3d 813 (Cal. 2005).

166. *Id.* at 815.

167. *Id.* at 830-31 (George, C.J., dissenting).

168. *See id.* at 830.

169. *City of Oakland*, 104 P.3d at 836.

obviously raise issues that are distinct from those involved in the disputes over dueling state and local anti-predatory lending laws. The New York, California, and Ohio courts focused closely upon the parallel nature of the state and local laws. Because both sets of laws were modeled after the federal anti-predatory lending statute, the simultaneous appearance of state and local laws regulating the same practice in the same manner clearly invited preemption attacks.

Local ordinances creating mediation programs and encouraging loan modifications are likely to bring state preemption challenges as well. Lenders may point to the general state regulation of their industry and, more specifically, to the state regulation of foreclosure procedures. They will claim that the state preempted the field, either expressly or impliedly, by establishing judicial and nonjudicial means of foreclosure.

Local governments may respond to preemption arguments in different ways, depending on whether their state follows judicial or nonjudicial foreclosure methods. In judicial foreclosure states, local governments may wish to draft ordinances as directives for the courts to exercise their power and discretion within a framework set by the ordinances. The problem here may be the local government's lack of authority over the state's judiciary. In particular, the state supreme court may be the only body with authority to modify court procedures. For nonjudicial foreclosure states, the problem is somewhat different, as discussed below.

3. The Providence, Rhode Island, Foreclosure Diversion Ordinance and Similar Local Legislation

Regulation of nonjudicial foreclosures through a local ordinance may present a different problem. The fate of the Providence, Rhode Island, law is a good example. In July 2009, the City of Providence passed an ordinance requiring a conciliation conference before a valid nonjudicial foreclosure sale could occur. The ordinance set a sixty-day period for conciliation and prohibited the recorder of deeds from recording a foreclosure sale deed without a certification of the lender's good faith compliance with the conciliation requirement. A later amendment allowed the city to impose a $2000 fine against any lender that failed to comply with the ordinance.

Several major servicers challenged the Providence law.[170] They argued that general state foreclosure law preempted the local ordinance and that the city exceeded its powers under its home rule charter in enacting the law.[171] In particular, the servicers pointed to the state recording statute requiring a recorder of deeds to accept any tendered deed.[172] Thus, the servicers argued,

170. *See* Deutsche Bank Nat'l Trust Co. v. City of Providence, P.C. No. 10-1240 (R.I. Super. Ct. May 17, 2010), *available at* http://www.courts.state.ri.us/superior/pdf/10-1240.pdf.

171. *See id.* at 1.

172. *See id.* at 4.

the ordinance prohibited the Providence recorder of deeds from accepting filings they were required to record under the general state statute. Furthermore, the general state law voided any conveyance of lands by way of mortgage unless it was recorded.

A Rhode Island Superior Court struck down the City of Providence's limitation on the recording of foreclosure deeds. In the court's view, the state assembly had set up a comprehensive set of regulations for recording land records documents. The state had occupied this field under the implied preemption doctrine recognized under state law. The city's home rule authority to enact legislation related to local matters did not extend to issues that are historically of statewide concern, such as the uniform state deed recording system.[173]

Preventing non-complying servicers from recording a foreclosure sale deed was the ultimate means the City of Providence had to enforce its ordinance. The court's decision undercut this enforcement device. The court did, however, leave intact the remaining terms of the ordinance. Thus, the city can still require that servicers participate in the conciliation process established under the ordinance. Although it may not restrict the recording of foreclosure deeds, the city can impose fines for non-compliance with its ordinance and, presumably, institute other enforcement mechanisms that do not undercut the recording system.

The servicers also argued that the Providence ordinance had to be invalidated because it improperly added time to the foreclosure procedures authorized by the general state statute. The court rejected the servicers' argument, noting that the timeframes under the state statute did not guarantee completion of a foreclosure within a fixed time. Instead, the general state law set some minimum time requirements for certain foreclosure events, such as advertisements. In allowing sixty days for conciliation conferences, the Providence ordinance did not interfere with any fixed statutory deadlines. In any preemption dispute involving state versus local foreclosure procedures, the precise language of the general state statutes will be critically important. The locality's own needs should play a role as well.

Thus far, other than the challenge to the Providence ordinance, conflicts between general state laws regulating foreclosures and local ordinances covering the same area have not been the subject of litigation. However, some types of laws regulating property rights have been the focus of preemption disputes. These laws encompass landlord and tenant eviction procedures, rent control, and condominium conversion. For example, in many instances, states have enacted comprehensive statutory schemes to regulate landlord-tenant relations. At the same time, local governments have sought to regulate various aspects of these relations, ranging from ordinances dealing with property

173. *See id.* at 8.

conditions, security deposits, discrimination in tenant selection, the amount of rent charged, forms of notice and procedures for eviction, and decisions to take rental properties off the market. The results of preemption litigation in these areas have not been uniform. The outcomes have varied widely from state to state, due to differences in the structure of home rule grants and in the degree to which the state legislature has expressly addressed the type of regulation. Therefore, a decision from one state will seldom carry much weight in another.

At one end of the spectrum is the case of *Inganamort v. Borough of Fort Lee*,[174] the landmark decision of the New Jersey Supreme Court upholding a Newark rent control ordinance against a preemption challenge. The Newark ordinance in question had been enacted in furtherance of the city's police power to respond to a shortage of affordable rental housing deemed to constitute an emergency.[175] The court rejected arguments to the effect that regulating property interests differently in one part of the state was inappropriate. Additionally, the court saw no compelling need for uniform statewide practices. Noting that the ability to meet local needs was part of the value of home rule legislation, the court stated:

> [T]he Legislature may invest in local government the police power to devise measures tailored to the local scene. The Legislature may decide to do so for sundry reasons. A problem may exist in some municipalities and be trivial or nonexistent in others. And if the evil is of statewide concern, still practical considerations may warrant different or more detailed local treatment to meet varying conditions or to achieve the ultimate goal more effectively.[176]

The court went on to observe that this diversity could be particularly important where local government is "equipped to deal with matters of local concern which, if left to State action, might not be met expeditiously or at all."[177] According to the *Inganamort* court, the powers of local government must be liberally construed under the home rule provisions. Most importantly, the court did not require a specific delegation of authority from the state to the local governments to enact rent control laws. The general authority to enact laws in furtherance of the police power was sufficient. As the court noted:

> That control of rents affects the exercise of the right to contract with respect to property is undeniable. But the right to contract is subject to the police power and no less so when the police power is exerted at municipal level. Whether an ordinance relates to zoning, or contains a housing code, or imposes upon the

174. 303 A.2d 298 (N.J. 1973).
175. *See id.* at 301.
176. *See id.* at 302.
177. *Id.* at 304.

> landlord duties relating to health, it necessarily limits the use of property or the right to contract with respect to it. That the ordinance imposes restraints which the State law does not, does not spell out a conflict between State and local law. On the contrary the absence of a statutory restraint is the very occasion for municipal initiative. The police power is vested in local government to the very end that the right of property may be restrained when it ought to be because of a sufficient local need.[178]

The California Supreme Court adopted similar reasoning in upholding a local rent control law against a state preemption challenge in *Birkenfeld v. City of Berkeley*.[179] More recently, local legislation affecting property rights have been upheld against similar preemption challenges.[180] At the other end of the spectrum, a number of appellate courts have invalidated ordinances regulating property as in conflict with statewide regulatory schemes.[181]

4. The Roles of Judges, Clerks, and Sheriffs

If state legislatures, state supreme courts, and local government entities will not act to encourage loss mitigation efforts before allowing homes to be sold in foreclosure, is there a role for local officials? Judicial and nonjudicial

178. *See Inganamort*, 303 A.2d at 307 (internal citation omitted).

179. 550 P.2d 1001 (Cal. 1976).

180. *See* People v. Little, 192 Cal. Rptr. 619 (App. Dep't Super. Ct. 1983) (upholding ordinance subjecting purchasers at foreclosure sale to local rent control law); Rental Prop. Owners Ass'n of Kent Cnty. v. City of Grand Rapids, 566 N.W.2d 514, 515-16 (Mich. 1997) (rejecting property owners' challenge to ordinance authorizing padlocking of rental properties under nuisance control rationale); Zorn v. Howe, 716 N.Y.S.2d 128, 128-29 (App. Div. 2000) (upholding local ordinance allowing eviction for drug-related conduct not grounds under state law); City of New York v. Park S. Assocs., 529 N.Y.S.2d 261 (Sup. Ct. 1988) (upholding local prohibition on certain unlawful evictions); Margola Assocs. v. City of Seattle, 854 P.2d 23 (Wash. 1993) (en banc) (upholding ordinance requiring landlord registration); *see also* Page v. City of Chicago, 701 N.E.2d 218, 224-26 (Ill. App. Ct. 1998) (discussing local police power in context of municipal ordinance barring employer discrimination beyond state statute's scope).

181. *See* Action Apartment Ass'n v. City of Santa Monica, 163 P.3d 89, 101 (Cal. 2007) (holding state litigation privilege preempts city ordinance authorizing tenants to sue landlords for harassing litigation); Johnson v. City of San Francisco, 40 Cal. Rptr. 3d 8, 12 (Ct. App. 2006) (holding state statute governing removal of rental units from market preempts local ordinance adding notice requirement); Bohbot v. Santa Monica Rent Control Bd., 34 Cal. Rptr. 3d 827, 829 (Ct. App. 2005) (invalidating anti-eviction and rent control ordinance as preempted by state eviction statute allowing prohibited practice); Channing Props. v. City of Berkeley, 14 Cal. Rptr. 2d 32, 37 (Ct. App. 1992) (holding state statute requiring sixty days notice to remove rental property from market preempted local ordinance requiring six months); Ba Mar, Inc. v. County of Rockland, 566 N.Y.S.2d 298, 299 (App. Div. 1991) (holding state law preempted field of mobile park regulation, invalidating local laws restricting evictions); *see also* Fields v. Taylor, 80 N.Y.S.2d 159 (App. Div. 1948) (holding municipality cannot regulate eviction proceedings by granting successive stays conflicting with state judicial procedures); Tartaglia v. McLaughlin, 77 N.Y.S.2d 31, 37 (Sup. Ct. 1947) (holding ordinance requiring certificate before eviction preempted by state law and improper interference with judicial review), *rev'd*, 79 N.E.2d 809 (N.Y. 1948). The 1948 *Tartaglia* decision reversed the appellate court's 1947 holding, which had found a municipality ordinance preempted by state law, because following that earlier decision, the state legislature had incorporated the municipal ordinance by statute. *See* Tartaglia v. McLaughlin, 79 N.E.2d 809, 810 (1948).

foreclosures raise similar, but distinct issues related to these questions.

a. Judicial Foreclosures

Judges typically exercise authority over the entire conduct of judicial foreclosures. Before allowing entry of a foreclosure decree, judges may apply their general equitable powers to consider the extent the mortgage holder exercised bad faith in refusing to consider loss mitigation.[182] After entry of a foreclosure decree, judges often retain some discretion in the scheduling of a sale. State statutes and statewide court rules, however, may set time limits within which a sale must take place. These rules may require a sale within a fixed time, or before or after a specific procedural event.[183] If such a limit applies, it is unlikely that an individual judge will have authority to schedule sales outside of these deadlines. At the other end of the spectrum, state statutes and state supreme court rules may give local administrative judges significant authority over scheduling events at the local level.

If there are no express limits set by general court rule or statute, a judge presiding over a judicial foreclosure should be able to exercise discretion in scheduling the sale.[184] There are obviously limits to a court's discretion, and a judge cannot abuse these limits. To varying degrees, certain courts have taken hardship and emergency into account in deciding whether to allow a foreclosure to proceed.[185]

If the court has discretion to take emergency conditions into account for individual cases, and the same conditions affect a large number of pending foreclosures, a judge should have authority to extend stays for groups of similar cases pending in the same court. This form of general relief becomes particularly appropriate when there are alternatives still available that are financially in the mortgage holder's interest, such as loss mitigation options, and those alternatives have not been exhausted. Similarly, if homeownership can be preserved while awaiting the implementation of state or federal legislation that will offer relief to distressed homeowners, a judge's equitable

182. *See, e.g.*, Wells Fargo Home Mortg., Inc. v. Neal, 922 A.2d 538, 552 (Md. 2007).

183. *See* Fed. Land Bank of St. Louis v. Blackshear, 38 S.W.2d 30, 31 (Ark. 1931) (stating mortgaged premises may be sold if indebtedness not paid within fixed period of time); Cent. Trust Co. v. Alcon Developers, Inc., 403 N.Y.S.2d 396 (Sup. Ct. 1978) (noting referee must schedule sale within statutory timeframe).

184. *See* Union Guardian Trust Co. v. Bldg. Sec. Corp., 273 N.W. 424, 429 (Mich. 1937); Page v. Austin, 169 So. 826 (Miss. 1936); Fed. Land Bank of Columbia v. Wells, 172 S.E. 707, 711 (S.C. 1934).

185. *See, e.g.*, Bisno v. Sax, 346 P.2d 814, 821-22 (Cal. Dist. Ct. App. 1959); Reynolds v. Ramos, 449 A.2d 182 (Conn. 1982); Savarese v. Schoner, 464 So. 2d 695, 696 (Fla. Dist. Ct. App. 1985); Fed. Home Loan Mortg. Corp. v. Taylor, 318 So. 2d 203, 208 (Fla. Dist. Ct. App. 1975); Crane v. Bielski, 104 A.2d 651, 654 (N.J. 1954); Associated E. Mortg. Co. v. Young, 394 A.2d 899 (N.J. Super. Ct. Ch. Div. 1978); Graf v. Hope Bldg. Corp., 171 N.E. 884, 886-89 (N.Y. 1930) (Cardozo, C.J., dissenting); Germania Life Ins. Co. v. Potter, 109 N.Y.S. 435, 437 (App. Div. 1908); Caspert v. Anderson Apartments, 94 N.Y.S.2d 521, 560 (Sup. Ct. 1949); Murphy v. Fox, 278 P.2d 820, 824 (Okla. 1955); United States v. Loosley, 551 P.2d 506, 508 (Utah 1976).

powers should extend to granting stays in individual and multiple foreclosure cases to ensure that homeowners have the chance to benefit from these measures. Again, this exercise of power assumes there are not specific contrary limits set by state statute or general court rules.

b. Nonjudicial Foreclosures—Ministerial and Discretionary Actors

Nonjudicial foreclosures are typically characterized as proceedings by private parties to enforce private contracts. However, this is not always the case. To varying degrees, public officials play roles in most nonjudicial foreclosures.

In Colorado, the court approves a request for a sale and a public trustee conducts the sale.[186] In North Carolina, a court clerk must determine as a preliminary matter whether a sale may go ahead.[187] In Georgia, the court confirms a sale if the lender seeks a deficiency. In Maryland, the person conducting a sale must file a report of sale with the court. In Massachusetts, the lender must file Soldiers' and Sailors' Civil Relief Act information with the court before initiating foreclosure.[188] In Michigan, the sheriff distributes surplus proceeds from a sale. In Virginia, the trustee files a report with the local commissioner of accounts who approves the distribution of any proceeds. In each of these instances, a nonjudicial sale will not be complete or valid unless the public officials perform these tasks.

Public officials play a number of indirect but essential roles under many statutory nonjudicial foreclosure systems. Lenders must record a notice of default or "order to docket" with a local clerk before proceeding with a nonjudicial foreclosure sale in some jurisdictions. In Massachusetts, the lender must file a pre-sale notice with various public officials.[189] Lenders must record the actual notice of sale with public officials in Arizona, California, Idaho, Maryland, Texas, Washington, Montana, and Utah. Public officials must conduct the nonjudicial foreclosure sales in Michigan and Minnesota. A sheriff signs off on the foreclosure sale deed in Maryland, Michigan, and Minnesota. In New Hampshire, the record of the sale must be filed with the registry of deeds, and in Maryland, with the court.

Use of public facilities is also built into many nonjudicial foreclosure statutes. Nonjudicial foreclosure sales must take place at the courthouse in Michigan, Texas, Alabama, Colorado, Montana, and Utah. In Mississippi, the notice of sale must be posted at the courthouse.

In these nonjudicial foreclosure jurisdictions, may a court clerk or town or

186. *See* COLO. REV. STAT. § 4-9-607 (2010).
187. *See* N.C. GEN. STAT. § 25-9-607 (2010).
188. *See* MASS. GEN. LAWS ch. 244, § 14 (2010).
189. *See* 28 ARTHUR L. ENO, JR. ET AL., MASSACHUSETTS PRACTICE SERIES § 10.1 (4th ed. 2010) (detailing practice of foreclosing on mortgage and conducting sales in Massachusetts).

county land records clerk refuse to accept filings from foreclosing lenders due to a local emergency caused by a multitude of nonjudicial foreclosures? May local officials bar lenders from using the local courthouse for posting notices or conducting sales?

The answer to these questions depends on the degree to which these local officials have authority to exercise discretion in carrying out their duties. In almost all cases the answer will be no. For example, town recording officials can be subject to a mandamus action and compelled to perform their ministerial duties as defined by state statute.[190]

Finally, self-help eviction is not allowed under any known system of nonjudicial foreclosure. In all jurisdictions, the lenders or third parties who purchase homes at foreclosure sales must obtain court approval for an eviction. A sheriff, constable, or similar law enforcement official must execute the court order turning the house over to the purchaser at the sale. May courts refuse to issue process necessary to effectuate these orders for possession? May sheriffs act independently to delay, or refuse to serve and execute, the eviction orders?

Courts can exercise discretion in granting judgments for possession in post-sale ejectment or unlawful detainer actions. Ejectment actions, like foreclosures, are often subject to the court's equitable power of review. A New York court, for example, has held that courts can deny lenders equitable relief in a foreclosure action based upon their conduct related to the foreclosure sale.[191] Under this analysis, a court should be able to deny ejectment relief to a lender if it failed to comply with procedural and substantive requirements related to a mediation program or with mandatory loss mitigation obligations such as those applicable to HAMP participants. Unless a statute grants them discretion in executing court judgments, it is unlikely that sheriffs or constables will have similar discretionary authority in deciding when and how to enforce an order for eviction.

XI. CONCLUSION

As a result of the judicial reevaluation of the Contracts Clause that began in the 1930s, states now have significant latitude to act in fashioning responses to the ongoing foreclosure crisis. Beginning during the Great Depression, state statutes enacted in response to severe upswings in home foreclosures relied heavily upon the inherent equitable powers of courts to supervise foreclosures, and the appellate courts upheld these laws. Based on modern interpretations of

190. *See generally In re* MERSCORP, Inc. v. Romaine, 861 N.E.2d 81 (N.Y. 2006) (indicating county clerk lacks authority to "look beyond" otherwise satisfactory instruments).

191. *See* Fed. Nat'l Mortg. Ass'n v. Ricks, 372 N.Y.S.2d 485, 496 (Sup. Ct. 1975) (holding lender's failure to comply with federal guidelines may constitute grounds for denial of relief). The New York court recognized that even though federal guidelines established under the Department of Housing and Urban Development (HUD) were not previously legally binding, courts can exercise their equitable powers to deny lenders foreclosure relief if lenders fail to comply with such guidelines. *See id.*

the scope of the Contracts Clause, it is clear that state legislation may direct the courts' exercise of discretion in ways that will promote the preservation of homeownership, despite impairment of mortgage holders' existing contract rights. Foreclosure restrictions that do not extinguish mortgage holders' liens and preserve the ultimate remedy of a forced sale upon a future default should satisfy the basic protections for mortgage holders guaranteed by the Contracts Clause and Takings Clause.

Foreclosure mediation programs, as created under recent state enactments, do not conflict with the Contracts Clause if they require evidence of a servicer's loss mitigation efforts prior to allowing a foreclosure to proceed. Neither the delays nor the disclosure aspects of such programs exceed the degree of interference in debtor-creditor relations permitted under prior Supreme Court rulings. Whether state laws can enforce the implementation of specific loss mitigation options over the objection of servicers and mortgage holders is not clear. To the extent that such provisions preserve mortgage holders' liens and allow foreclosure upon future default, a law conditioning foreclosure upon compliance with reasonable loss mitigation actions should not be found in violation of the Contracts Clause or the Takings Clause.

Local governments may also play an important role in prevention of foreclosures. State law preemption, however may limit these local government powers in some instances. In the absence of clear state law preemption, local governments should have authority to regulate foreclosures equal to that of the states. In addition, local courts may have powers to regulate court proceedings under delegated authority from a state legislature or state supreme court. The local courts may exercise this authority to regulate judicial foreclosures in a number of ways that will require accountability from mortgage holders who seek to use the court system to foreclose.