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"Mandatory Mediation Programs: Can Bankruptcy Courts Help End the Foreclosure Crisis?"

Hearing of the Senate Judiciary Committee's Subcommittee on Administrative Oversight and the Courts

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Chairman Whitehouse, thank you for inviting me to speak before the Subcommittee on the role that bankruptcy courts can play in helping to alleviate the mortgage foreclosure crisis.

I am one of 11 bankruptcy judges in the Southern District of New York, with nine judges in Manhattan, one judge in Poughkeepsie and one judge in White Plains. I will discuss the program that became effective in our court in January 2009. I have attached to my written testimony copies of program documents currently in use, including procedures, commencement instructions, form of notice and form of order. All of these documents are available on the court's public website at www.nysb.uscourts.gov under the "Forms" tab.[1]

I will also provide some data on the use and results of the program from its inception in January 2009 through October 21, 2010.

Let me first give you some background on how the program was developed. As the national foreclosure crisis unfolded, bankruptcy courts across the country have faced substantially increased consumer bankruptcy filings. New consumer bankruptcy cases—particularly under chapter 13 of the Bankruptcy Code—are often filed on the eve of a foreclosure

[1] As described in the text below, our court, with the assistance of several committees of debtors' and creditors' lawyers, has reviewed the program and the current documents. Some changes will be made to the program documents within the next few weeks, but none of these changes will make any major substantive changes in the existing program.

sale, after a borrower has seemingly exhausted consensual or state court efforts to avoid foreclosure. During 2008, after speaking with a few lawyers representing creditors (loan servicers and lenders), several of my colleagues and I began exploring whether the bankruptcy court could develop a program to better address the problems of both debtors and lenders. Bankruptcy judges, of course, must provide equal justice to debtors and creditors. We endeavored to create a program to ameliorate the effects of the foreclosure crisis on borrowers and lenders alike, consistent with existing provisions of the Bankruptcy Code. In adopting our Loss Mitigation Program, we were among the first bankruptcy courts to develop a formal program to help alleviate the mortgage foreclosure crisis.

Our adoption of the Loss Mitigation Program coincided with U.S. Treasury's creation of the HAMP program, which provides incentives for lenders and loan servicers to negotiate loan modifications with borrowers. Changes to the HAMP program since it was first created have also made it easier for bankruptcy debtors to make use of the HAMP program. HAMP eligibility requirements still exclude many debtors from obtaining a HAMP loan modification, but increasingly lenders and loan servicers are willing to consider non-HAMP modifications.

After receiving encouragement from individual lawyers representing debtors and creditors, we arranged several larger meetings with debtors' and creditors' lawyers to flesh out the elements of a possible program. The most encouraging thing about these meetings was that there was no significant divide between debtors' and creditors' lawyers on the major issues: all of the lawyers with whom we met supported developing a program that would provide a means for lenders and borrowers to reach agreements to avoid foreclosure, if possible, or to find other consensual solutions. Following these meetings, we prepared a draft of the loss mitigation program, circulated the draft to the judges on our court and to the lawyers with whom we met.

We then made some changes in response to comments we received. The court then published the program documents on the court's website for public comment. After the public comment period, with only a few small changes, our board of judges adopted the Loss Mitigation Program, effective in early January 2009.

The program applies to any individual debtor in a case filed under chapters 7, 11, 12 or 13 of the Bankruptcy Code, including joint debtors. It applies to any real property or cooperative apartment used as a principal residence in which an eligible debtor holds an interest. The program applies to all loans, whether considered subprime or nontraditional, whether or not the property was in foreclosure prior to bankruptcy, whether the loan is a first or junior mortgage or a lien on the property, and whether or not the loan was pooled, securitized and assigned to a loan servicer or to a trustee.

While loan modification is one of the goals of the Loss Mitigation Program, our program procedures make clear that loan modification is not the only successful outcome. Our program procedures state that "Loss mitigation commonly consists of the following general types of agreements, or a combination of them: loan modification, loan refinance, forbearance, short sale, or surrender of the property in full satisfaction. The terms of a loss mitigation solution will vary in each case according to the particular needs and goals of the parties." Debtors and their lawyers have often recognized after having a lender or loan servicer representative with whom to negotiate that keeping a home is an unrealistic option. There can still be benefits to the debtor and the lender to agree upon a short sale or surrender of the property in full satisfaction (avoiding a potential deficiency judgment). The longer a debtor keeps an unaffordable home, the more liability the debtor continues to face for property taxes, insurance premiums, home owner assessments, zoning violations and others.

Let me be clear at the outset that our results to date have been modest, but nevertheless helpful, in allowing homeowners to remain in their homes and lenders to avoid additional foreclosures. Chapter 13 of the Bankruptcy Code is designed for debtors with regular income. If a debtor is unemployed and has no other source of regular income, chapter 13 is unlikely to help. A loan modification is unlikely if a debtor has no income to make mortgage payments.

Because of the way data has been captured by our court in the past with respect to loss mitigation, there are limitations in the information I am able to report. These numbers are based on the best information available to the court at the present time. We are in the process of reconfiguring our data collection methods to provide better data in the future.

Since the inception of the program (through October 21, 2010) our court has received approximately 1450 requests for loss mitigation. Of these, about 1000 requests were filed in chapter 13 cases; 25 in chapter 11 cases; and 425 in chapter 7 cases.

Our Clerk's office reports that approximately 1250 orders have been entered granting loss mitigation requests.[2] This means that the debtor and the lender or loan servicer commenced a period to discuss loss mitigation; it does not mean that a successful outcome was achieved. Only 55 orders have been entered denying loss mitigation requests, after the court heard and sustained objections by the lender or loan servicer. These numbers are a good indication how infrequently a lender or loan servicer objects to entering into loss mitigation negotiations. The objections

[2] Because a debtor may and often does have more than one mortgage on a property, the number of orders entered granting or denying loss mitigation does not necessarily correspond to the number of cases in which loss mitigation has been requested.

have usually been filed in cases of serial or abusive bankruptcy filers, with little or no income, and no prospects for any successful outcome in loss mitigation.[3]

"Outcomes" data—the final results of loss mitigation in particular cases—are harder to come by. Until recently, our Clerk's office did not capture outcomes data, but a manual review of docket records has been performed for our court in Poughkeepsie where the largest numbers of loss mitigation requests were filed. Additionally, until recently, HAMP loan modifications required a 90-day trial period before a borrower could receive a permanent loan modification. It is not clear whether our data set has captured all trial modifications, or, for that matter, all final modifications.

Loss mitigation requests were made in approximately 900 cases in Poughkeepsie; loan modifications were approved in approximately 220 cases; approximately 450 loan modification requests are still pending; and approximately 230 requests have been denied or withdrawn. Successful loan modifications have resulted in reductions in monthly mortgage payments in the range of $100-$1,000 per month. In a few cases, substantial principal reductions also resulted (including, a $120,000 principal reduction in one case). For a debtor living at the edge of financial collapse reductions in monthly mortgage payments in this range can mean the difference between remaining in a family home, with children enrolled in local schools and neighborhood stability maintained, or having family life totally disrupted in searching for new housing and schools, assuming they can be found with the funds available to a debtor.

Anecdotally, over the last six months my colleagues and I have seen increased willingness by lenders and loan servicers favorably to consider loan modification requests. This

[3] There have been approximately 150 cases in which loss mitigation requests were made, but the debtor's counsel did not follow through with the additional steps required to trigger loss mitigation, such as submitting the loss mitigation order for entry by the court.

appears to be driven by a number of factors: lenders increasingly recognize that they are better off economically by agreeing to a loan modification than by foreclosing on property; lenders are not anxious to own additional property, and buyers at foreclosure sales at reasonable prices are scarce; experience and familiarity with our loss mitigation program has demonstrated that outcomes favorable to debtors and lenders can be achieved at lower costs than with litigation alternatives.

Our loss mitigation procedures require the parties to negotiate in good faith. A party that fails to participate in loss mitigation in good faith may be subject to sanctions. Each loss mitigation party must have a person with full settlement authority present during a loss mitigation session. One or more loss mitigation sessions may be conducted in person, telephonically or via video conference. Our procedures also provide that a debtor or creditor participating in the loss mitigation program may request, or the bankruptcy court may order, the appointment of an independent mediator from our court's register of mediators. Requests for appointment of mediators have only occurred in a few cases, and the court has been able to select pro bono mediators acceptable to the parties. In most cases, the parties have negotiated directly without mediators. Indeed, this highlights one of the most frequent favorable comments I have heard from attorneys about our program—namely, that requiring the parties to identify a person with settlement authority with whom to discuss loss mitigation provides the best chance for a favorable outcome. Many lawyers representing debtors have advised that before filing for bankruptcy their clients were unable to engage in meaningful loan modification discussions with a person with any authority to act on behalf of the lender.

After the entry of a loss-mitigation order a lender is authorized to contact the debtor directly without violating the automatic stay. A lender or loan servicer may not file a lift-stay

motion during the loss mitigation period, except where necessary to prevent irreparable injury, loss or damage. Any lift-stay motion filed prior to entry of the loss-mitigation order is adjourned to the last day of the loss mitigation period and the court's time to resolve a lift-stay motion is extended pursuant to section 362(e) of the Bankruptcy Code (ordinarily terminating the stay 30 days after the lift-stay motion is filed unless the court, after notice and a hearing, orders the stay continued). In a chapter 13 case, the deadline by which the creditor must object to confirmation of the chapter 11 plan is extended to permit the creditor an additional 14 days after the termination of loss mitigation.

At any time during the loss mitigation period, a loss mitigation party may request a settlement conference or status conference with the bankruptcy court. Our judges regularly request status reports with respect to loss mitigation during any hearing scheduled in the case during the loss mitigation period.

While a loss-mitigation order may be tailored to the specifics of each case, the suggested time frames are as follows: (1) each party shall designate contact persons and contact information within seven days after the entry of the order; (2) a creditor in loss mitigation shall contact the debtor within 14 days after the entry of the order; (3) each loss mitigation party must make any request for information within 14 days after the entry of the order; (4) each loss mitigation party shall respond to a request for information within 14 days after the request is made, or seven days prior to the loss mitigation session, whichever is earlier; (5) the loss mitigation session shall be scheduled within 35 days after the date of the order; (6) the loss mitigation period shall usually end within 42 days after the entry of the order, unless extended as provided in the loss mitigation procedures. Experience has shown that some of these suggested or required time periods need to be lengthened, and such changes are being considered at the

present time. Because lenders have usually required a 90-day trial period before agreeing to a final loan modification, confirmation hearings have usually been adjourned until the trial period has concluded and a decision by the lender or loan servicer on a final modification has been made.

Generally speaking, the granting of a loss mitigation request slows down case administration. In chapter 13 cases, confirmation of a case is usually delayed until after loss mitigation and any trial period has been concluded. A debtor's ability to confirm a chapter 13 plan often depends on whether the debtor can negotiate a loan modification. A successful loan modification will also affect the amount of disposable income available to pay other creditors. The judges on our court have concluded that the delays in administering cases in which loss mitigation has been ordered are justified by the clarity that loss mitigation can bring, whether the result of loss mitigation is a loan modification, short sale of property, surrender of property or no change at all.[4]

About one year after the Loss Mitigation Program became effective, several of our judges met with many of the same debtors' and creditors' attorneys to review the program and ask for suggestions about modifications or improvements. With the judges' approval, the lawyers formed several subcommittees to review different aspects of the program. Each subcommittee included both debtors' and creditors' attorneys. The subcommittees reported back with several suggestions for program improvements. The most significant change will require the parties to

[4] In discussing our loss mitigation program with judges on other bankruptcy courts, some judges have raised concerns about the impact on their already overcrowded calendars. In many districts around the country bankruptcy judges handle extraordinarily large dockets of chapter 13 cases. Those judges' concerns about the impact of loss mitigation on their dockets are certainly real. However, my experience has been that very little additional court time has been required by our loss mitigation program. Most of the activity occurs outside of court between the loss mitigation parties. While cases may remain open and active on the court's docket for a longer time, that usually does not expand the work of the judge.

specify early in the process and under oath the information requested by each party and the information actually provided. This should expedite the loss mitigation process and limit the circumstances when one party or another asserts that it did not receive information necessary to evaluate a loan modification request.

Finally, I am aware that a very similar loss mitigation program adopted by the bankruptcy court in Rhode Island is currently the subject of a constitutional challenge. The issues raised in the challenge will obviously need to be decided by the federal courts in Rhode Island. However, I want to emphasize that our judges considered our authority to adopt our loss mitigation program before it became effective in January 2009. It was the view of our judges then and now that our unquestioned authority to adopt mediation programs and procedures—long in place in our court and courts elsewhere in the country—applies equally to our loss mitigation program which is modeled on our district's mediation program. We may require parties in a contested dispute to meet and confer, directly or with a mediator, in an effort to resolve the issues between them, without the court imposing any particular result. Any party objecting to loss mitigation may present its objection to the court, and the court has indeed denied loss mitigation requests where the circumstances justify that result. We do require that the parties negotiate loss mitigation in good faith, as we do in any mediation, but that does not compel a procedure or result contrary to any provision of the Bankruptcy Code.

Chairman Whitehouse, I would be happy to answer any questions you may have. Thank you again for the opportunity to appear before the subcommittee.