

Testimony

to the

Senate Special Committee on Aging

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regarding

**Foreclosure Aftermath: Preying on Senior Homeowners**

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## **INTRODUCTION**

Mr. Chairman, Senator Smith, and Members of the Committee. Thank you for inviting me to testify today regarding “Foreclosure Aftermath: Preying on Senior Homeowners.” Thank you also for holding this hearing to examine the issue of what are now commonly known as “mortgage foreclosure rescue scams.” I offer my testimony today on behalf of Legal Aid Society of Milwaukee’s low income clients.<sup>1</sup> I appreciate the opportunity to speak about the experiences of victims of these scams in Milwaukee County. Our experience is representative of communities across the United States.

The Legal Aid Society provides legal representation to hundreds of Milwaukee County residents facing foreclosure. There were more than 5,600 mortgage foreclosures filed in Milwaukee County in 2007, an increase of 55% over 2006. With the increase in foreclosures, unfortunately, we have experienced the appearance of “mortgage foreclosure rescue scams.” Over the past two years, the Legal Aid Society has seen an increasing number of victims of these scams, a significant percentage of whom are senior citizens.

In late 2005, an eighty-three-year-old woman and her daughter, Yvonne and Susan Klermund, came to our office describing a very disturbing and unusual situation. They had been served with eviction papers in an attempt to remove them from their own home of more than 30 years. These women had great difficulty explaining what had happened to them, but they were distraught. Fortunately, I had just returned from a conference addressing the problem of “mortgage foreclosure rescue scams,” presented by the National Consumer Law Center (“NCLC”).<sup>2</sup> I had also read a comprehensive report issued by NCLC in June 2005, “Dreams Foreclosed: The Rampant Theft of Americans’ Homes Through Equity-Stripping Foreclosure ‘Rescue’ Scams.”

Upon investigation, the Legal Aid Society discovered that through a web of trusts, deeds, and Power of Attorney, the Klermunds had lost their home to a mortgage rescue scam. The perpetrators of the scam had stolen the entire equity in their home -- over \$58,000. The Klermunds received nothing, not one dime. The Legal Aid Society has represented the Klermunds for more than 2 years in extensive litigation over these transactions. On Christmas Day, 2007, Yvonne passed away. I dedicate my testimony today to her memory and her courage in continuing her fight against this scam as her health failed.

The Klermunds’ case was our first involving mortgage foreclosure “rescues” schemes.

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<sup>1</sup>The Legal Aid Society of Milwaukee, Inc. was founded in 1916 “to do all things necessary for the prevention of injustice.” We are one of the nation’s oldest, continuously operating, public interest law firms. Each year the Legal Aid Society provides free legal services to 8,000 of Milwaukee’s most vulnerable residents. Since 1916, Legal Aid Society has made it a priority to represent consumers and homeowners in foreclosures.

<sup>2</sup>NCLC is a non-profit Massachusetts Corporation, founded in 1969, specializing in low-income consumer issues. See website: [www.consumerlaw.org](http://www.consumerlaw.org).

Since then, Legal Aid Society has been in the forefront of efforts to combat mortgage rescue fraud in Wisconsin. We have litigated numerous cases of fraud and have worked very closely with law enforcement and criminal prosecutors to bring these scam artists to justice. The Legal Aid Society has worked with the Wisconsin Legislature for passage of a bill that will strictly regulate the foreclosure consultant business and the sale of properties in foreclosure.

## **MORTGAGE FORECLOSURE RESCUE NIGHTMARES**

The perpetrators of these scams learn this “business” through late night television infomercials and seminars held at local hotels. The scams are big business and have spread across the country. They range from simple theft to complex schemes involving *inter-vivos* trusts, money laundering, and tax dodges.

Mortgage foreclosure “rescue” scams take many forms, but each scam has one common trigger: the victims are in default on their mortgage loans and face foreclosure. The foreclosure process is traumatic enough, but in a desperate attempt to get out from under foreclosure, homeowners become victims of predators looking to make a fast buck by stealing the remaining equity in their homes. The greed and callous indifference of the “rescuers” is mind-boggling.

In Milwaukee County, as is true throughout the country, the “rescuer” finds his/her victims through on-line services that identify homeowners facing foreclosure. In its simplest form, a “rescuer” charges an outrageous fee to provide assistance to the homeowner that does not materialize. In its more complex forms, through intricate schemes and conspiracies, the rescuer strips the equity out of the victim’s home.

There are two loosely identifiable forms of these scams: mortgage foreclosure “consultants” and foreclosure reconveyances schemes. A mortgage foreclosure “consultant” offers to perform various services on behalf of a foreclosed homeowner, such as stopping a sheriff’s sale, assisting the homeowner to negotiate a workout plan with the mortgage company, or, if all else fails, at least get the equity in the home.

A foreclosure reconveyance scheme usually involves a transaction (or series of transactions) in which the homeowner transfers title to the “rescuer” who then allows the homeowner to remain living in the home, paying rent, until the homeowner is able to repurchase the home. Under either form of the scam, the homeowners end up worse off than they were before.

### **Mortgage Foreclosure “Consultants”**

Mr. B, an elderly widower, was in default on his mortgage. He was contacted by a man who represented himself as working for a company that provided assistance to individuals in default. The “rescuer” said that he would work with the lender to get a loan modification agreement or other arrangement that would allow Mr. B to stay in his home. All Mr. B had to do was pay a \$1,500 fee, and the “consultant” would negotiate to put his mortgage back on track.

Mr. B paid the \$1,500, his entire savings. He never heard from the “rescuer” again. Mr. B’s many calls went unanswered. His home went through foreclosure and was sold at sheriff’s sale. Mr. B had no savings left to pay for his relocation.

Another form of the foreclosure “consultant” scam common in Milwaukee County is theft by the use of a Power of Attorney. Again, the “rescuer” finds victims in foreclosure, but does further investigation of the foreclosed properties to find homes with equity. Once a victim is identified, the rescuer contacts the homeowner by mail, personal solicitation, or telephone, offering to help save the victim from sheriff’s sale, preserve the equity in his/her homes, get cash and a fresh start. I am attaching several examples of the types of solicitations sent to potential victims that are designed to engender a sense of sympathy and understanding with the potential victim’s financial problems. (See Exhibit #1).

Take, for example, Mr. and Mrs. K. The Ks were the perfect victims. Mr. K was terminally ill. He and his wife had gone into debt to pay for medical expenses. Their house was in foreclosure, but there was equity in their home. The foreclosure “consultant,” Pamela, sent them several very sympathetic letters offering to help them stop the sheriff’s sale, save the equity in their home, and get them much needed cash. Desperate, they called her and made an appointment for her to come to their home and discuss how she could help them.

Pamela arrived with a Power of Attorney already prepared for the Ks’ signatures. She explained that the Power of Attorney would allow her to take care of everything regarding the sale of their home. Trusting Pamela, the Ks moved into an apartment. Several weeks later, they received a call from a former neighbor, advising them that their house had been sold and someone was moving in. Mrs. K called Pamela who told her that the house had indeed been sold and that Pamela was very sorry, but there was nothing left from the sale, only enough to pay Pamela’s fee. Expecting to receive \$20,000 or more from the sale, the Ks were devastated. Mr. K died soon after the sale, consumed with worry about his wife’s financial future.

Two years later, when a Wisconsin Department of Justice attorney visited Mrs. K, she learned the truth. The sale of their house had actually netted \$32,000, and Pamela had kept the entire net proceeds, 35% of the sale price, as her “Intermediary Fee.” This fee was never disclosed to the Ks. The Power of Attorney the Ks signed did not authorize Pamela to take this fee. It was theft by a fiduciary, pure and simple. I have attached the closing statement from the sale of the Ks’ home which shows the net proceeds paid to Pamela as an “Intermediary Fee.” (See Exhibit #2).

A similar case is that of Mrs. J, a 65-year-old widow. Under circumstances similar to the Ks, Mrs. J gave a Power of Attorney to a “rescuer,” Albert. Albert took the entire net proceeds from the sale of Mrs. J’s home: \$54,738.91. Attached is a document entitled “Disbursement of Proceeds” prepared by Albert. (See Exhibit #3). It divies up the sale proceeds among a group of people, most of whom Mrs. J had never heard of. This “Disbursement of Proceeds” is reminiscent of a gang of thieves dividing up the loot, leaving nothing for Mrs. J. The closing agent, a local title company, issued checks payable to these people, apparently

without question.

### **Mortgage Foreclosure Reconveyance Schemes**

Ms. D, a low-income disabled mother of two small children, went into foreclosure. Ms. D read an ad in a local shopping guide promoting a company that could help people get out of foreclosure. She called the number in the ad and spoke to a rescuer, Jeffrey, who explained that he could help her save her home. His plan was to find a buyer for her home and rent her home back to her for one year. After a year, Jeffrey assured Ms. D that he would assist her to get a new mortgage so she could repurchase her home.

Jeffrey got his son, Jason, to purchase Ms. D's house. Jason took out a loan against Ms. D's home. After payment in full of Ms. D's mortgage, Jeffrey and Jason helped themselves to the entire net proceeds of the sale, \$11,700. After one year, Ms. D contacted Jeffrey to repurchase her home and was told that she did not qualify for a mortgage loan and could not repurchase her home. Jason then sold the home to another buyer for \$112,000, making an additional \$40,000 on the sale of Ms. D's home. Altogether the rescuers netted \$51,000 from the sale of Ms. D's home. Ms. D. has had to find another place for her and her children to live.

Another example is Ms. T. After her home went into foreclosure, she was contacted by Mia. Ms. T had considerable equity in her home. Mia offered to enter into a transaction with Ms. T under the terms of which Mia would loan Ms. T \$7,300 to pay the arrearage and reinstate her mortgage. In exchange, Mia had Ms. T sign over ownership to her home to Mia. Mia, a licensed mortgage broker, assured Ms. T that she would be able to repurchase her home with a mortgage Mia would assist her in obtaining. Mia represented to Ms. T that when the refinancing was obtained, Ms. T would have to repay the rescuers \$12,300 from the loan proceeds, and title to her home would be returned to her name. The terms of the transaction also provided, however, that if Ms. T was not able to refinance and repurchase her home within 6-months, Mia could sell the home and keep the entire sale proceeds.

It goes without saying that Ms. T was not able to refinance within the 6-month period. She had just had a foreclosure filed against her, and she was unable to qualify for a new loan. This is a fact that would have been well-known to Mia, a mortgage broker. Ms. T came to the Legal Aid Society when the rescuers were about to sell her home and keep the entire profit.

### **LEGAL THEORIES AND REMEDIES CURRENTLY AVAILABLE TO CHALLENGE MORTGAGE FORECLOSURE RESCUE SCAM TRANSACTIONS**

The above stories demonstrate the devastating results of mortgage foreclosure rescue scams. However, these victims were lucky in one respect -- they were able to find legal

representation at the Legal Aid Society. Most victims lack the resources to retain legal representation. Few attorneys are experienced in recognizing these scams and litigating them.

In Milwaukee County, federal and state criminal prosecutors have been investigating the most egregious of these cases, but the scams are complicated, and the resources of prosecutors are already stretched to the limit. Although we look forward to criminal prosecutions in many cases, it is often necessary to pursue civil litigation first in our effort to reclaim the stolen real or personal property within the statute of limitations.

### **Current Federal and State Claims**

Under the current state of the law in Wisconsin, when representing victims, the Legal Aid Society must piece together legal claims from federal statutory law and Wisconsin common and statutory law -- often dusting off old law books -- to bring claims for void conveyances and equitable mortgages. We bring claims of intentional misrepresentation, theft by fraud, breach of fiduciary duty, and similar claims. Where appropriate, we bring claims under Truth-in-Lending, Home Ownership Equity Protection Act, the Wisconsin Consumer Act and Wisconsin's Unfair and Deceptive Practices Act ("UDAP").

### **Claims against Affiliates of the Rescuer**

In addition to the rescuer, there may be other parties who have participated in the scam to varying degrees.

- "Straw Buyer" - Often the person who purchases the home of the victim has been recruited by the rescuer in order to obtain the mortgage to fund the scam. Legal Aid brings claims of civil conspiracy or aiding and abetting against these participants in the scheme.
- Appraiser - Frequently the financing of the scheme is based on a fraudulent appraisal of the property. We commonly bring claims against the appraiser for fraud.
- Closing Agent - Many of these scams are consummated in the offices of a closing agent. Many closing agents turn a blind eye to the details of the scam, earning fees for the closing and letting the fraud take place without questioning the rescuer's conduct. Legal Aid Society has brought claims of negligence and breach of fiduciary duty against closing agents.
- Mortgage brokers and lenders - The financing of these schemes is through mortgage loans. Occasionally it is clear that the mortgage broker or lender knew or should have known that the transaction was fraudulent, and in such cases, Legal Aid Society has included them as defendants.

Pursuing claims against the rescuers and their affiliates requires complex and lengthy litigation. Many of the claims the Legal Aid Society relies on require proof of intent or other special elements. Other claims are based on archaic common or statutory law with little, if any,

recent case precedent. The facts are so strange that judges sometimes have difficulty wrapping their heads around the issues. Proving damages can be very complicated. In other words, litigating these cases is complex, expensive, and challenging.

## **PROPOSED SOLUTIONS**

Seeking redress for these frauds on a case by case basis is impossible. Clearly a better approach is legislation that will prevent the occurrence of the scams in the first place.

### **Wisconsin's Legislation**

Wisconsin is in the process of enacting legislation that will regulate transactions involving real estate in foreclosure. Patterned on legislation passed in several other states, including Minnesota and Illinois, Wisconsin's legislative proposal regulates the two forms of foreclosure rescue scams I have described today: foreclosure consultants and foreclosure reconveyances.

For consultants the bill would require, among other things, that any agreement between a foreclosure consultant and homeowner be in writing and that it include a three-day right to cancel. The law would also: (1) prohibit the consultant from receiving compensation for services until the consultant has fully performed each and every service in the contract; (2) prohibit the consultant from acquiring any interest in the property or becoming a power of attorney for the homeowner; and (3) prohibit the consultant from charging a fee that exceeds 8% of any loan the consultant makes to the homeowner.

In terms of the second type of transaction – reconveyance agreements – the new law would bar any agreement that is unfair or commercially unreasonable, and where an agreed upon reconveyance does not take place, the law entitles the homeowner to at least 82% of the fair market value of the property. The new law would also provide homeowners with a stay of eviction where violations of the act are alleged.

Remedies under this proposed legislation include a private right of action for statutory and actual damages and criminal penalties.

### **Recommendation Solutions**

The testimony presented today demonstrates the need for appropriate legislation and regulation to protect vulnerable homeowners in foreclosure, many of whom are senior citizens. From my experience representing many victims of mortgage foreclosure rescue scams, many homeowners facing foreclosure become paralyzed by fear and embarrassment and become perfect victims for solicitations from rescuers. It is time to stop these scams and direct foreclosed homeowners to legitimate avenues of assistance.

Federal legislation should be enacted to protect foreclosed homeowners from

unscrupulous mortgage rescue “consultants”<sup>3</sup> and should include, among other things:

- A requirement that there be a written contract between the consultant and the foreclosed homeowner prior to the provision of any services and that the contract be subject to a right to a 3-day right to cancel.
- A prohibition against demanding or receiving compensation for services until the services have been fully performed.
- A restriction on the interest and fees which are charged in the event the consultant makes a loan to the homeowner.
- An outright prohibition against the homeowner granting power of attorney or ownership in property to the consultant.
- An explicit clause that preserves remedies and rights otherwise available to the foreclosed homeowner. Fourteen states have laws or regulations which restrict the activities of mortgage foreclosure “rescuers,” and several states, including Wisconsin, have legislation pending. Federal legislation should be in addition to state statutes and any other statutes or regulations which might apply in each victim’s particular situation.
- Because of the resources for criminal or administrative enforcement are stretched to the limit, it is essential that any federal response authorize a private right of action to enforce federal remedies.

Other remedies might include:

- Encouraging the Federal Reserve pursuant to its authority under the Home Ownership Equity Protection Act to declare that foreclosure rescue scams are an unfair and deceptive practice.
- Declare rescue scams to be unfair and deceptive under the Federal Trade Commission Act.
- Strengthen remedies under Real Estate Settlement Practices Act for failure of the rescuer to provide a good faith estimate of costs of the loan as required under RESPA and for submission of fraudulent HUD Settlement Statements. The current remedies under RESPA are very weak and ineffective and need to be strengthened. In addition, RESPA should be amended to provide for a private

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<sup>3</sup>Regulation of mortgage reconveyance scams involves individual state property and foreclosure laws and therefore is inappropriate for federal legislation.



right of action for violations.

- An investigation into the involvement of closing agents in the scams either through direct participation in the scams or through negligence in conduct of the closing.
- Amend HOEPA so that its provisions would apply to the first scam and eliminate the requirement to prove that the rescue scammer has made two or more such transactions in a 12-month period.

The Legal Aid Society of Milwaukee looks forward to working with Chairman Kohl and other members of this committee to develop a strong, effective response to stop these outrageous scams.