CHAPTER 5B

Foreclosure Rescue Scam Litigation*

SYNOPSIS

* This chapter was written by Melissa A. Huelsman. Ms. Huelsman is a Seattle-based attorney admitted to practice in California and Washington, and before the Ninth Circuit Court of Appeals, United States District Courts for the Western and Eastern Districts of Washington, and the United States District Court for the Central District of California. Her practice involves plaintiff's civil litigation in the areas of predatory lending and mortgage loan servicing, fraud and foreclosure rescue scams. She also practices in the United States Bankruptcy Court. Ms. Huelsman is a member of King County Bar Association and participates in its Volunteer Legal Services Program by handling numerous predatory lending and foreclosure scam *pro bono* cases. Ms. Huelsman was named KCBA's Pro Bono Lawyer of the Year in 2006 and was previously recognized by VLS as one of its Volunteers of the Year and has received a similar award from the Urban League of Seattle/Metropolitan King County. Ms. Huelsman is Chairperson of the PLACE Subcommittee of the Seattle-King County Coalition for Responsible Lending and on the CENTS (Consumer Education and Training Services) Board of Directors. She is also a member of the National Association of Consumer Advocates.

Ms. Huelsman has spoken on the issues of predatory lending and foreclosure rescue scams at numerous CLEs and Bar functions, including sessions for the National Consumer Law Center and NACA; for the Washington State Bar Association; Oregon State Bar Association; King County Bar Association; King County Housing Authority; the Urban League; Fremont Public Association; International District Housing Alliance; HomeSight and other community organizations. She has also appeared in pieces about her clients involved in predatory lending and foreclosure rescue scams in an NCLC Report called Dreams Foreclosed.

§ 5B.01 Introduction: Anatomy of a Foreclosure Rescue Scam

The first key to understanding foreclosure rescue scams is the concept of "home equity." Home equity is simply the difference between the market value of a home and the total amount debt on the property. For instance, a home that is worth $250,000, but is subject to a $100,000 mortgage, will have $150,000 of home equity (assuming there are no other liens or debts against the property). A homeowner's equity is often the greatest financial asset he or she possesses.

The foreclosure of a home threatens the homeowner with the loss of that equity, as well as the home itself. For many homeowners who have owned their homes for significant periods of time and have raised the families in the home (often generations of family members), the loss of the home can be emotionally devastating and something that is incomprehensible. Most homeowners find the notion of the loss of the home something that must be avoided at all costs. It is this emotional attachment to their homes that make homeowners facing foreclosure particularly vulnerable to false promises that they can save the home with the assistance of the scammer.

The key to understanding how foreclosure rescue scams work is to appreciate the circumstances of a homeowner facing the loss of a home through foreclosure. Typically, a homeowner delinquent on a mortgage loan will have several viable options available for preserving either the home itself or the accumulated equity in the property. Ideally, if the homeowner has the means to cure the delinquency in a fairly short period of time, the homeowner can probably "reinstate" the loan—that is, pay the delinquent amount, late fees and other associated charges necessary to bring the loan current. Once reinstated, the homeowner may then continue to make payments on the loan according to its original schedule. Some lenders may cooperate with delinquent borrowers to facilitate workout or loan modification plans that can enable borrowers to reinstate their loans and get back to making mortgage payments. However, legitimate and sustainable reinstatement or loan modification programs (also sometimes called forbearance agreements) are hard to come by and most homeowners spend a great deal of time trying to resolve the situation, only to find themselves frustrated and having wasted significant amounts of time waiting on hold and then finally speaking with representatives who transfer them around to other extensions (often non-working extensions), ask them to send the same paperwork over and over and over again, and/or to find the call terminated.[1]

If a homeowner is not able to reinstate the loan, another alternative is refinancing. Refinancing essentially involves taking out a brand new loan to pay off the old loan. The new loan may have a lower monthly payment, or a graduated payment schedule, or other terms that might better enable the borrower to repay. Refinancing is a particularly attractive option for homeowners with substantial equity who may have encountered a temporary income disruption, but is generally not a solution for those whose mortgage debt simply exceeds their means. Refinancing is also extremely difficult in today's market conditions, even for those with excellent credit scores. For a homeowner who is currently in foreclosure, obtaining a refinance may be virtually impossible.

Another alternative that may be helpful to some financially distressed homeowners is a Chapter 13 bankruptcy proceeding. Known as "reorganization," a Chapter 13 bankruptcy proceeding may enable a homeowner to preserve homeownership and restructure his or her debts so that the homeowner's income is used to pay required mortgage payments and other necessary living expenses. The remainder of the homeowner's income is then paid to the Chapter 13 Trustee and used to pay the arrears on the mortgage(s) and any other secured creditors over a period of 36 to 60 months. Any of the funds paid to the Trustee in excess of the amounts used for secured creditors are paid to unsecured creditors on a *pro rata* basis. But Chapter 13 bankruptcy is not a solution for all homeowners—particularly those whose income is not sufficient to "fund a plan," which means having enough income to effectively reorganize their debts and preserve their important assets, including the home.

For a homeowner who cannot reinstate, who cannot or would not benefit from refinancing the loan, who cannot or would not benefit from a bankruptcy petition, the best remaining option is to sell the home at fair market value. While not an ideal solution for many, given not only the psychological attachment to one's home but also the practical difficulties of relocation, a sale, at or near fair market value, enables the homeowner to pay off the debt and preserve the equity—which, even for low-income homeowners, often reaches into 5 or 6 figures. It is important to note that there have been significant changes in fair market values in the last year or so, and future fair market values in most markets remain questionable for the near future, but there are still many homeowners with valuable equity in their homes.

Homeowners facing foreclosure often do not fully comprehend their circumstances, and may not be aware of these alternatives. Or they may lack the information necessary to evaluate the alternatives and make a wise decision. Some homeowners may lack the education or mental ability to intelligently weigh their alternatives. Other homeowners' thinking may be clouded by uncertainty, desperation and fear. Such

[1] *See* CA Rep. Maxine Waters trying to reach the loan servicer by telephone on behalf of a constituent. http://abcnews.go.com/Blotter/Story?id=6702731&page=1.

homeowners are prime targets for scam artists who hold themselves out as experts in the field and approach homeowners with offers of help and reassurance. Many scammers also gain the trust of their victims through supposed religious affiliations, racial and ethnic affiliations, and social networking affiliations. The scammers have the veneer of respectability and professional credibility, and all too often they are real estate agents, mortgage brokers and other types of real estate professionals, adding an additional layer of "believability."

A foreclosure rescue scam is a transaction or set of related transactions designed to prey upon these very vulnerable homeowners. The scammer's objective is to take all, or a substantial portion of, the homeowner's equity without providing any material or equivalent benefit in return. Ordinarily, the scammer poses as a person seeking to earn a reasonable fee by helping the homeowner avoid foreclosure and preserve the home and the equity. The scammer then coerces the homeowner to enter into a transaction or series of related transactions wherein the homeowner loses both the home and the equity to the scammer, rather than to the foreclosing entity. The scam artist's agenda is to orchestrate foreclosure rescue scams in order to make as much money as possible in the guise of trying to "rescue" borrowers from foreclosure.

While foreclosure rescue scams differ immensely in their finer details, the basic strategy is generally the same:[2]

(1) the "scam artist" will obtain a deed to the homeowner's property, invariably in connection with a lease or other agreement whereby the homeowner retains possession of the property and the purported right to "repurchase" the home;

(2) the scam artist will reinstate and/or pay off the delinquent mortgage to preserve the home from foreclosure, while the homeowner continues to reside in the property and pay "rent" to the scam artist; and

(3) then, rather than allow the original homeowner to "repurchase" the property, the scam artist will assert ownership of the property outright and remove the homeowner.

(4) or, alternatively, the price for which the homeowner would be permitted to reacquire the property is set so high that it is impossible for the "repurchase" to occur.[3]

(5) or the homeowner actually reacquires the property but is required to pay a huge

---

[2] It is imperative when analyzing a foreclosure rescue scam transaction not to be concerned with whether the details of the transaction(s) are slightly different than those described herein. Scam artists are very creative and constantly tweaking these schemes. Variations abound, but they all terminate with the same result—the homeowner has been removed from the home. The scammer will have acquired all of the equity from the house or allowed the house to be foreclosed by the lender while pocketing all of the payments made by the now former homeowner.

[3] The fact that the homeowner is virtually certain to be unable to obtain a new loan in order to reacquire the property is evidenced in the significant delinquencies which lead to the foreclosure in the first place. A homeowner who has been so delinquent in making mortgage payments that it results in the initiation of a foreclosure is unlikely to be able to get a new loan within a year or two of the foreclosure. The situation is further exacerbated by the fact that the homeowner is required to purchase the home from the scammer or his cohorts rather than seek a refinance. It is much easier for a homeowner to qualify for a refinance loan than it is to qualify for a purchase loan.

fee to the "scam artist" to complete the transaction. (This happens very infrequently and when it does happen, the homeowner can pay tens of thousands of dollars to the "scam artist").

In most cases, transactions of this kind enable the scam artist to obtain the homeowner's property for the cost of reinstating or paying off the homeowner's mortgage(s). The scam artist may then either begin making payments on the homeowner's existing mortgage loan, while receiving payments from the homeowner greatly in excess of the mortgage payment amount or to refinance the property in a much higher amount in order to obtain the equity in case. Ultimately, once the homeowner is removed, the scammer will sell the property for fair market value (and sometimes even more when he/she arranges for an inflated valuation and finds a willing buyer), and retain the difference (i.e, the equity). The net result is that the homeowner loses the property and retains none of the equity, and the scammer ends up with the property or with all of the equity.

Certainly no reasonable homeowner would willingly and knowingly enter into this sort of transaction if he/she understood how the transaction really works and that it is very unlikely the transaction will result in a return to homeownership. Therefore, it should not be surprising that foreclosure rescue scam artists like to prey upon the most vulnerable homeowners, such as the elderly, people with cognitive or mental disabilities, etc. However, victims of foreclosure rescue scams come from all walks of life and levels of abilities. They all share the common trait of searching desperately for some method of preserving their homeownership. It should be noted that homeowners facing foreclosure are almost always under considerable stress and emotional turmoil. But still, scam artists must frequently (if not always) engage in a good deal of deceit, trickery, exploitation, and other abusive practices to carry out these appalling transactions.

Common tactics include:

- **describing the transaction terms orally** to the homeowner, but preparing documents containing different (less favorable) terms;
- arranging for homeowners to sign **incomplete or blank documents** (then filling in the terms later);
- using **delay tactics** to undercut the homeowner's ability to utilize other alternatives (often waiting until just a day or two before the foreclosure before "allowing" the homeowner to sign the documents);
- adding **exorbitant fees** into the transaction;
- **withholding** important documents and information from the homeowner, and so on.

In some cases, scam artists will resort to **outright forgery or other crude devices** to complete a transaction.

Consider a hypothetical example:

Joe Homeowner bought his house for $125,000 20 years ago. He paid $25,000 down at the time and financed the remaining $100,000 over 30 years. Joe still owes $50,000 on the house, but now the property is worth $250,000. Unfortunately, Joe has suffered some financial setbacks lately and cannot afford the $600 per month payments on the house. He failed to make last month's payment and with fees and penalties, he now needs $2,000 to reinstate, and the amount owed will only increase in the weeks leading up to the foreclosure. Joe's options are: (1) try to come up with the money to reinstate; (2) refinance the house; or (3) sell the house.

Reinstatement probably is not a good long-term solution for Joe. He might be able to come up with the $2,000 this time, but if Joe cannot afford $600 per month for 10 more years, then he will run into trouble again. Refinancing might be a good plan; if he refinances now at a good interest rate, he could cut his monthly payments in half. But if Joe still can't afford the new reduced payment, then he should sell the house. If Joe sells the house now for $250,000, he can pay off the rest of his mortgage from the sale proceeds and keep the remaining $200,000 in equity.

Joe, from our example, is an ideal potential victim of a sale-leaseback scheme. He is facing foreclosure and in a tenuous financial position. Yet Joe has substantial equity in his home—about $200,000 is potentially available. Now, let's imagine that Mick, an enterprising "foreclosure rescue expert" learns of Joe's situation and proposes the following transaction:

(1) Joe will quitclaim the property to Mick for $50,000;

(2) Mick will lease the property back to Joe for 12 months at $500 per month;

(3) Mick will pay off Joe's $50,000 mortgage; and

(4) At the end of the 12 months, Joe can buy the property back from Mick for $55,000

If Mick persuades Joe to enter into this transaction, Mick will have achieved Step 1 of the classic foreclosure rescue scam operation: Mick will have obtained a deed to Joe's property. Assuming Mick then pays off Joe's delinquent mortgage, all that stands between Mick and Joe's $250,000 property is to effectively assert ownership and remove Joe from the picture. Mick might accomplish this final step in any number of ways. A partial list of common tactics includes:

(i) Joe could fail to pay the monthly rental amount and be evicted for non-payment of rent;

(ii) Mick could seek to terminate Joe's tenancy for other reasons;

(iii) Joe could fail to secure financing to repurchase the property (which is virtually certain);

(iv) Mick could omit Joe's option to repurchase from the transaction documents;

(v) Mick could prepare transaction documents materially differing from the transaction terms orally stated to Joe, for instance, by setting the repurchase price at $100,000 instead of $55,000 or setting the monthly rent at $800 instead of $500 (as compared to the previous mortgage payment of $600 per month);

(vi) Mick could simply refuse to sell the property back to Joe, or demand a higher price;

(vii) Mick could re-sell the property without Joe's knowledge. . .

Again, while the details will vary in any given case, the end result is generally the same: the scam artist makes off with the equity (or the property); the homeowner's previous mortgage is paid but the homeowner loses the house and receives none, or almost none, of the equity (or, alternatively, the property is eventually foreclosed anyway and the scammer has simply pocketed the "rent" money). In the above example, if Mick is successful in removing Joe from the house, Mick will have obtained a $250,000 asset for only about $50,000. Mick could presumably then sell the house himself for $250,000 or more and retain the difference.

Although in the interest of simplicity this summary has focused so far on a simple sale-leaseback transaction involving only a homeowner and a scam artist, it bears mention that most sale-leaseback scams involve at least one additional layer of complexity: the third-party "investor." That is, in most scams the homeowner conveys the property not directly to the scam artist, but to a third-party investor who is often, though not always, a confederate of the scam artist. The scam artist serves as an intermediary between the homeowner and the investor, and collects her portion of the appropriate equity either through a fee arrangement with the homeowner, a side-agreement with the investor, both, or through some other mechanism altogether. Here is an example of such a scheme:

> Joe owns a home worth $300,000, but owes $150,000 on a mortgage to Clash Bank. Joe's mortgage is in default. Mick approaches Joe and offers to "help save the home." After advising Joe that a mortgage is "out of the question" due to Joe's poor credit, Mick recommends "finding an investor for a sale-leaseback" transaction. After describing the concept of a sale-leaseback generally to Joe, Mick states, "at this point, it's probably your only hope." Joe authorizes Mick to "search for an investor."
>
> Two weeks later, Mick informs Joe that Nick will buy the property and lease it back to Joe, with a right to repurchase. Mick tells Joe he can "set up the whole thing for $10,000." Joe agrees to pay Mick a $10,000 fee for arranging the transaction. Mick also reaches an agreement with Nick whereby Mick will receive "30% of the profits" on the transaction. Mick then arranges for Joe to convey the property to Nick for $165,000, with Joe to pay all closing costs; Mick assures Joe that Joe will have a right to repurchase the home for $165,000 but this provision is not incorporated into any of the transaction documents. Nick takes out a $165,000 loan from Mescalero Bank, and uses the proceeds to pay off Joe's $150,000 mortgage, Mick's $10,000 "commission," and $5,000 in assorted closing costs, leaving Joe with $0 from the sale. Nick executes a 12-month lease agreement with Joe for $1,000 per month. Joe pays Nick $1,000 per month for 12 months, and Nick uses the money to make the payments on the Mescalero Bank loan. At the end of the 12 months, Nick declines to renew Joe's lease and demands possession of the property. Joe obtains approval for a $165,000 loan to repurchase the property but Nick refuses to sell for less than $300,000, so Joe is unable to reacquire title. Nick sells the property to Paul for $300,000, and pays off Mescalero Bank. Paul brings eviction proceedings against Joe, while Nick and Mick divide up their $135,000 gain.
>
> **Nick has made $94,500 ($300,000 sale price—$165,000 to Mescalero Bank =**

$135,000 profit, —30% to Mick); Mick has made $50,500 (30% of $135,000 + the $10,000 commission); Paul owns the house, and Joe has nothing.

Summary

What are the options when a homeowner defaults on a mortgage loan?

- **Reinstate.** (Homeowner cures the default, keeps the property, loan continues as before.)
- **Refinance.** (Homeowner takes out new loan to pay off old loan; new loan terms should be more affordable.)
- **Sell.** (Homeowner sells property for fair market value and pays off loan, keeping remaining equity.)
- **Foreclosure Rescue Scam.** (Homeowner conveys house for below market value, leases back, anticipates re-purchasing property in future.)
  - **Homeowner loses home and all equity** *because* Homeowner fails to fulfill terms of lease and/or repurchase agreement.
  - **Homeowner loses home and all equity** *because* repurchase agreement omitted from written documents.
  - **Homeowner loses home and all equity** *because* new "owner" unwilling to re-sell (or demands higher price).

§ 5B.02 Legal Theories

[1] Equity & Common Law

There are numerous equity theories upon which a victim of a foreclosure rescue scam may seek relief. An understanding as to the contours of each theory is essential to properly advise victims of foreclosure rescue scams and to formulate effective litigation strategies.

[a] Equitable Mortgage

The "equitable mortgage" doctrine, a long-enduring fixture of equity, essentially means that:

> **Where the transactions actually occurring between the parties are clearly of such a nature as to show a deed absolute in form to have been a mortgage, courts of equity will construe it as such.[1]**

Put another way, a court has the equitable power to declare a "deed"—an instrument purporting to convey title—to be a "mortgage." In other words, it would be an instrument conveying only a security interest, not title to the grantee.

The equitable mortgage doctrine is critical to unraveling sale-leaseback scams because in many such scams, the victim will have signed a "deed" purporting to convey title of his/her home to another party (usually the scam artist or a confederate).

---

[1] Plummer v. Ilse, 41 Wash. 5, 11, 82 P. 1009 (1905), Moore v. Cycon Enterprises Inc., (Case No. 1:04-CV-800), 2006 US Dist. LEXIS 57452 (WD Mi. 2006).