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The Foreclosure Echo: How Abandoned Foreclosures Are Re-Entering the Market Through Debt Buyers

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THE FORECLOSURE ECHO: HOW ABANDONED FORECLOSURES ARE RE-ENTERING THE MARKET THROUGH DEBT BUYERS

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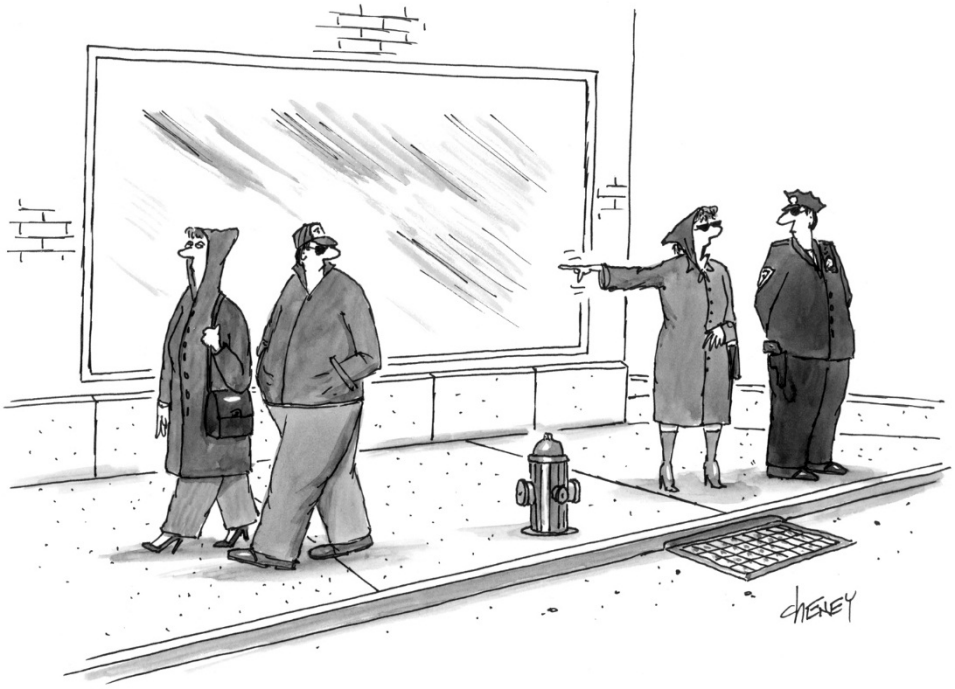

"Officer, that couple is just walking away from their mortgage!"

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[1] TOM CHENEY, © The New Yorker Collection, 2012, *available at* www.cartoonbank.com.

I. INTRODUCTION

The financial crisis and resulting rise in home foreclosures has drawn a great deal of attention in recent years.[2] As housing prices fell and mortgage defaults grew, the financial services industry began to complain about a perceived increase in "strategic defaults."[3] A strategic default is a voluntary mortgage default and the subsequent abandonment of the home by a homeowner who has the financial ability to pay the mortgage. There is considerable debate among contract scholars about the morality of this action and I leave that debate to them.[4] A more practical question is whether strategic defaults actually occur. Numerous researchers have tried to determine the circumstances

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[2] THE FINANCIAL CRISIS COMMISSION, FINAL REPORT OF THE NATIONAL COMMISSION ON THE CAUSES OF THE FINANCIAL AND ECONOMIC CRISIS IN THE UNITED STATES, 280-91, 402-10 (Jan. 2011) [hereinafter Commission Report].

[3] *See generally* FICO, FICO HELPS TOP MORTGAGE SERVICER COMBAT STRATEGIC DEFAULTS: $20 BILLION PROBLEM FACING MORTGAGE INDUSTRY CALLS FOR IMMEDIATE ACTION, (Oct. 10, 2011), http://www.fico.com/en/Company/News/Pages/10-10-2011.aspx; Keith Jurow, *Strategic Defaults Revisited: This Could Get Very Ugly*, BUS. INSIDER (Apr. 29, 2011, 10:18 AM), http://www.businessinsider.com/strategic-defaults-revisited-it-could-get-very-ugly-2011-4.

[4] *See generally* Tess Wilkinson-Ryan, *Breaching the Mortgage Contract: The Behavioral Economics of Strategic Default*, 64 VANDERBILT L. REV. 1547, 1582-83 (2011) (recognizing that due to the bad behavior of banks and the remote connections homeowners have to the lenders in a world of securitization, homeowners have fewer moral qualms about default); Brent T. White, *The Morality of Strategic Default,* ARIZ. L. STUD. (Discussion Paper No. 10-15, May 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1597835 (arguing that strategic default can be economically rational, and thereby a moral decision). *But see* Curtis Bridgeman, *The Morality of Jingle Mail: Moral Myths about Strategic Default,* 46 WAKE FOREST L. REV. 123 (2011) (arguing that true strategic default, defaulting when you can afford to pay the mortgage, is not morally defensible); William Redmond, *Strategic Foreclosure as an Indicator of Eroding Institutional Structures,* 2 J. ECON. ISSUES 565 (2012) (arguing that the social acceptability of voluntary foreclosure is growing). For a broader discussion, *see* Meredith R. Miller, *Strategic Default: The Popularization of a Debate Among Contract Scholars*, 9 CORNELL REAL EST. REV. 32 (2011); Steven Shavell, *Is Breach of Contract Immoral,* (Harvard John M. Olin Discussion Paper Series, Discussion Paper No. 531, Nov. 2005), *available at* http://www.law.harvard.edu/programs/olin_center/papers/pdf/Shavell_531.pdf ; Seane Shiffrin, *Could Breach of Contract be Immoral?*, 109 MICH. L. REV. 1551, 1552 (2009).

under which homeowners choose strategic default.[5] However, strategic defaults are not easily quantifiable because, as one industry study explains, "while the total number of defaults can be measured with a high degree of precision, whether or not those defaults are due to an *inability* to pay or an *unwillingness* to pay is typically unobservable from market data."[6] Therefore, the evidence to support the contention that the foreclosure crisis was caused by widespread strategic default is mixed, at best.[7] The

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[5] Currently, two general theories predominate: the strategic or ruthless default theory that holds that people will default when their mortgage exceeds their home equity by a defined threshold and the "two trigger" school which holds that the home equity differential, in and of itself, does not cause default. It must be combined with some kind of life crisis like divorce or job loss. Neil Bhutta, Jane Dokko, & Hui Shan, *The Depth of Negative Equity and Mortgage Default Decisions* (Div. of Research & Statistics & Monetary Affairs Fed. Reserve Bd., Fin. & Econ. Discussion Series, Paper No. 2010-35, 2010), at 3, *available at* http://www.federalreserve.gov/pubs/feds/2010/201035/201035pap.pdf. *See generally* Younghend Deng, John M. Quigley, & Robert van Order, *Mortgage Terminations, Heterogeneity, and the Exercise of Mortgage Options,* 68 ECONOMETRICS 275, 303 (2000) (finding a great deal of heterogeneity in the mortgage markets, making default predictions difficult. They do suggest, however, that homeowners with initial high loan to value loans are less likely to both default and pay off the loan early.); Christopher L. Foote, Kristopher Gerardi, & Paul S. Willen, *Negative Equity and Foreclosure: Theory and Evidence*, 64 J. URB. ECON 234, 270 (2008) (concluding, in a study of Massachusetts homeowners, that most people with negative equity do not default); Andra C. Ghent & Marianna Kudlyak*, Recourse and Residential Mortgage Default: Evidence from US States*, 24 REV. FIN. STUD. 3139 (2011) (finding that strategic defaults are higher for homeowners with more expensive homes in states where banks have no recourse); Patrick Bajari, Sean Chu, & Minjung Park, *An Empirical Model of Subprime Mortgage Default from 2000-2007*, (NBER Working Paper Series: Working Paper 14625, Dec. 2008), *available at* http://www.nber.org/papers/w14625 (finding securitization and pricing the reason for defaults).

[6] MICHAEL J. SEILER, ANDREW J. COLLINS, & NINA H. FEFFERMAN, RES. INST. FOR HOUSING AM., STRATEGIC DEFAULT IN THE CONTEXT OF A SOCIAL NETWORK: AN EPIDEMIOLOGICAL APPROACH 16 (Oct. 2011), *available at* http://www.housingamerica.org/RIHA/RIHA/Publications/78456_10923_Research_RIHA_Default_Report.pdf.

[7] *See generally* Bhutta, *supra* note 5, at 29(estimating that one in five mortgage defaults in the sample were strategic); Ghent, *supra* note 5, at 3177 (finding that borrowers with property values over $200,000 at originations, in non-recourse state increases the possibility of strategic default); Deng, *supra* note 5, at 303 (concluding that the heterogeneity of mortgage borrowers cause variations in default behavior); Foote, *supra* note 5, at 245 (unable to verify

most we can say is there is some evidence to suggest strategic defaults are higher for well-to-do homeowners with expensive homes located in states where lenders cannot obtain deficiency judgments after default.[8] Despite this, the financial industry has spent much time and effort creating models to predict strategic default[9] instead of working to mitigate the losses in foreclosure.[10] In response, and in light of widespread reports of lender abuse, some commentators have actually begun to advocate strategic default as a smart economic strategy.[11] Thus, it is unlikely that

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that negative equity alone causes strategic defaults).

[8] Ghent, *supra* note 5, at 3177. A deficiency judgment is an amount still owed to the lender at the end of the foreclosure process. For a more detailed discussion of deficiency judgments, *see* discussion *infra* Part III.

[9] *See generally* Experian-Oliver Wyman Market Intelligence Report: *Understanding Strategic default in mortgages, part one.,* www.marketintlligencereports.com; Experian-Oliver Wyman Market Intelligence Report*: Understanding strategic default in mortgages: Q2 2010 update*, *available at* www.marketintlligencereports.com; Yuliya Demyankyk, RALPH S.J. KOIJEN, & OTTA A.C. VAN HEMERT, FED. RESERVE BANK OF CLEVELAND, DETERMINANTS AND CONSEQUENCES OF MORTGAGE DEFAULT, *available at* http://www.clevelandfed.org/research/seminars/2010/demyanyk.pdf?WT.oss=determinants%20and%20consequences&WT.oss_r=392.

[10] Patricia A. McCoy, *Barriers to Foreclosure Prevention During the Financial Crisis*, 55 ARIZ. L. REV. 3, 10 (forthcoming 2013), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2254662. *See generally* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-11-93, MORTGAGE SERVICER ACTIONS COULD HELP REDUCE THE FREQUENCY AND IMPACT OF ABANDONED FORECLOSURES (2010) [hereinafter GAO-11-93]; Kristin M. Pinkston, *In the Weeds: Homeowners Falling Behind on their Mortgages, Lenders Playing the Foreclosure Game, and Cities Left Playing the Price*, 34 S. ILL U. L. J. 621 (2010).

[11] *See generally* Roger Lowenstein, *Just Walk Away: Why should underwater homeowners behave any differently than banks?*, N.Y. TIMES MAG., Jan. 7, 2010, at 15; Chris Taylor, *What Happens when you Walk Away from your Home*, REUTERS (Jan. 27, 2012, 2:52 PM), http://www.reuters.com/article/2012/01/27/us-housing-strategicdefault-idUSTRE80Q1XX20120127; Brad Tuttle, S*trategic Mortgage Default: The Irresponsible, Amoral, but best Strategy?,* TIME (Jan. 11, 2010), http://business.time.com/2010/01/11/strategic-mortgage-default-the-irresponsible-amoral-but-best-strategy/print/; Mandi Woodruff, *How to Strategically Default on Your Home and Live Scott-Free for Years*, BUS. INSIDER (Dec. 30, 2011, 10:50 AM), http://www.businessinsider.com/strategically-default-on-your-home-live-free-2011-12?op=1.

the rise in foreclosed and abandoned properties[12] was caused by strategic defaults.[13] Instead, the cause may be a systematic abandonment of low and moderate income neighborhoods by the housing industry.[14]

Whether strategic or not, mortgage defaults increased steadily from 2006 through 2011.[15] In some situations, lenders moved swiftly after default to foreclose the property; but for other homeowners the foreclosure process began and then stalled or was completely abandoned by the lender.[16] The result of these

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[12] *See generally* U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-12-34, VACANT PROPERTIES: GROWING NUMBER INCREASES COMMUNITIES' COSTS AND CHALLENGES (2011); Thomas J. Billitteri, *Blighted Cities: Is Demolishing parts of cities the way to save them?*, 20 CQ RESEARCHER 941 (Nov. 12, 2010); CITY OF SOUTH BEND VACANT AND ABANDONED PROPERTIES TASK FORCE, VACANT AND ABANDONED PROPERTIES TASK FORCE REPORT, (Feb. 2013), *available at* http://southbendin.gov/sites/default/files/files/Code_FinalVATF_Report_2_red.pdf.

[13] Michael Hiltzik, *Inflated threat of strategic default,* L.A. TIMES (Feb. 26, 2012), http://articles.latimes.com/2012/feb/24/business/la-fi-hiltzik-20120224; Richard DeKaser, *'Strategic Defaults" less Common than Thought*, WASH. POST (Aug. 7, 2010), http://www.washingtonpost.com/wp-dyn/content/article/2010/08/05/AR2010080507381.html.

[14] GAO-11-93, *supra* note 10, at 14. *See generally* GEOFF SMITH & SARAH DUDA, WOODSTOCK INSTITUTE, LEFT BEHIND: TROUBLED FORECLOSED PROPERTIES AND SERVICER ACCOUNTABILITY IN CHICAGO 6 (Jan. 2011), *available at* http://www.woodstockinst.org/sites/default/files/attachments/leftbehind_jan2011_smithduda_0.pdf (relating vacancies concentrated in minority neighborhoods to abandoned foreclosure); Janet L. Yellen, Vice Chair of Board of Governors of the Federal Reserve System, Remarks at the 2011 Federal Reserve Bank of Cleveland Policy Summit, *Housing Market Developments and Their Effects on Low-and Moderate Income Neighborhoods* (June 9, 2011), *available at* http://www.federalreserve.gov/newsevents/speech/yellen20110609a.pdf; JUDITH FOX, RICHARD WILLIAMS & BRIAN MILLER, FORECLOSURES IN ST. JOSEPH COUNTY, INDIANA FROM 2001-2007 (2008) (on file with author) (finding a correlation between living in a minority neighborhood and foreclosure).

[15] Commission Report, *supra* note 2, at 214-21 (describing the increase in mortgage deficiency by type of loan and region of the county); Shane M. Sherlund, *Mortgage Defaults* (Mar. 8, 2010), *available at* http://www.chicagofed.org/digital_assets/others/region/foreclosure_resource_center/more_mortgage_defaults.pdf (showing an increase in mortgage defaults beginning in 2006, but real acceleration in 2009).

[16] Linda Allen, Stavros Peristiani, & Yi Tang, *Bank Delays in the Resolution of Delinquent Mortgages: the Problem of Limbo Loans* (Fordham

abandoned foreclosures has been devastating to cities and consumers throughout the country.[17] This article explores what is happening to homeowners caught up in the strange world of bank walkaways as the economy is beginning to improve. This second wave of collection activity, an echo of the original foreclosure crisis, could easily throw thousands of consumers back into financial hardship just as the economic recovery begins.

Part I of this article explores the evidence of foreclosures started and then stalled or abandoned and their impact on consumers and communities. In Part II "the real zombie title" is introduced through evidence gathered in foreclosures in Indiana. This new form of "zombie loan" is a mortgage loan that has been foreclosed, but is suddenly and inexplicably "un-foreclosed." The effect of zombie loans on homeowner, judicial system and communities is also explored. Finally, Part III discusses the increased presence of debt buyers in both the buying of loans and the collection of deficiency judgment in relation to the overall

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University Schools of Business Research Paper No. 2018948), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2018948 (finding 21.79% of the loans in their sample of Florida foreclosures to be limbo loans); Linda E. Fisher, *Shadowed by the Shadow Inventory: A Newark, New Jersey Case Study of Stalled Foreclosures and Their Consequences*, 3 U.C. Irvine L. Rev. (forthcoming 2013) (finding that 37% of the cases in her study were in legal limbo); MICHAEL SCHRAMM, APRIL HIRSH, DIWAKAR VANAPALLI, DANIEL J. VAN GROL, KRISTA MOINE NELSON, & CLAUDIA COLTON, CENTER ON URBAN POVERTY AND CMTY. DEV., MANDEL SCH. OF APPLIED SOC. SCIENCES, STALLING THE FORECLOSURE PROCESS: THE COMPLEXITY BEHIND BANK WALKAWAYS (Feb. 2011), *available at* http://blog.case.edu/msass/2011/02/07/CUPCD_2011_02_07_Stalling%20the%20foreclosure%20process-%20the%20complexity%20behind%20bank%20walkaway.pdf (examining bank walkaways in Cleveland and finding that in 17% of their sample the bank had affirmatively walked away and in another 39% there was an unexplained delay by the bank in the foreclosure); KATIE BUITRAGO, WOODSTOCK INSTITUTE, DECIPHERING BLIGHT: VACANT BUILDINGS DATA COLLECTION IN THE CHICAGO SIX COUNTY REGION 3 (June 2013) [hereinafter DECIPHERING BLIGHT], *available at* http://www.woodstockinst.org/sites/default/files/attachments/decipheringblight_buitrago_june2013.pdf ("the phenomenon of foreclosures that are initiated but not pursued to auction increased the likelihood that the properties become vacant").

[17] *See generally* Pinkston, *supra* note 10. These calls to default are often connected to reports of lender misbehavior, including the evidence that banks make similar decisions about walking away from properties that are too far underwater to be worth foreclosing. *See supra* note 11 and accompanying text.

concern currently being voiced regarding the debt buying industry. The clever ways banks are managing their foreclosure inventory make clear that the effects of zombie loans must be mitigated in order to avoid a second economic downturn, the "foreclosure echo."

II. ABANDONED FORCLOSURES

Abandoned foreclosure, bank walkaway, "zombie title," and "limbo loan" are all terms used to describe a situation where a homeowner is in default, but the foreclosure does not proceed in the normal fashion to the eventual sale of the.[18] The phenomenon first surfaced in Midwestern rust belt states.[19] Congress, at the urging of Ohio representatives, called for an investigation into the relationship between vacant properties and abandoned foreclosures. The General Accounting Office commenced a study that was released in November 2011.[20] The study was limited in that it only examined loans owned by the large servicers and government sponsored entities.[21] It concluded that most servicers do an equity analysis before determining whether to initiate a foreclosure.[22] When it is not economically beneficial to foreclose, the lender charges-off[23] the loan without initiating a foreclosure.[24]

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[18] Different authors and commentators are using different terminology for the same actions. *See* GAO-11-93, *supra* note 10 ("abandoned foreclosure"); Allen et al., *supra* note 16 (limbo loans); SCHRAMM ET AL., *supra* note 16 (using the terminology "walkaway"); Michelle Conlin, *Special Report: The latest foreclosure horror: the zombie title,* REUTERS (Jan. 10, 2013, 1:58 PM), http://www.reuters.com/article/2013/01/10/us-usa-foreclosures-zombies-idUSBRE9090G920130110 (coined the term "zombie title").

[19] Susan Saulny, *Banks Starting to Walk Away on Foreclosure*, N.Y. TIMES, Mar. 30, 2009, at A20, *available at* http://www.nytimes.com/2009/03/30/us/30walkaway.html?pagewanted=print; Sandra Livingston, *Bank 'walkaways' from foreclosed homes a growing, troubling trend,* THE PLAIN DEALER (last updated July 19, 2009, 6:33 PM), http://blog.cleveland.com/metro//print.html?entry=/2009/07/bank_walkaways_from_foreclosed.html; Mary Ellen Podmolik, *More banks walking away from homes, adding to the housing* crisis, CHI. TRIB. (Jan. 13, 2011), http://articles.chicagotribune.com/2011-01-13/news/ct-biz-0113-walkaway—20110113_1_foreclosure-process-foreclosure-filing-servicers.

[20] GAO-11-93, *supra* note 10.

[21] *Id.* at 14.

[22] *Id.* at 15.

[23] The accounting term "charge-off" means the company writes off the loan as uncollectable. This allows the bank to take a tax deduction for the loss.

Some lenders reported initiating a foreclosure, but abandoning it before the property was brought to final foreclosure sale.[25] As illustrated in the GAO chart reproduced below, properties evaluated in the study were significantly more likely to be abandoned by the homeowner if the loan was charged-off after the foreclosure was initiated than if the charge-off occurred before the foreclosure process began.[26]

Table 1: Numbers of Charge-offs in Lieu of Foreclosure by Foreclosure and Occupancy Status, January 2008 through March 2010

	Foreclosure not initiated	Percent	Foreclosure initiated	Percent	Total	Percent
Total charge-offs in lieu of foreclosure	**27,620**	**60%**	**18,379**	**40%**	**45,999**	**100%**
Occupancy status of properties from point of charge-off in lieu of foreclosure to June 2010:						
Property occupied	19,412	70	9,603	52	29,015	63
Property vacant	8,208	30	8,776	48	16,984	37

Source: GAO analysis of data reported by six servicers.

[27]

While the number of abandoned homes related to abandoned foreclosures in this study was small as a percentage of all foreclosures, they were concentrated in certain areas, thus becoming a disproportionate problem for those communities.[28] Of those identified communities, most were located in the Midwest.[29] Since then, individual studies have documented the problem in Chicago, Illinois; Cleveland, Ohio; Newark, New Jersey; and the state of Florida.[30]

The lender can continue with collection efforts or sell the loan.

[24] GAO-11-93, *supra* note 10, at 15.

[25] *Id.* at 16.

[26] *Id.* at 17.

[27] *Id.*

[28] *Id.* at 16.

[29] Detroit, Chicago, Cleveland and Indianapolis had the largest numbers of abandoned homes due to abandoned foreclosures. Of the top twenty, thirteen were in the Midwest. South Bend and Mishawaka, Indiana, though not listed in the top cities, were identified as communities where the overall number was too small to put them in the top twenty, but whose numbers of abandoned properties as a result of abandoned foreclosure were significant relative to the size of the community. *Id.* at 22.

[30] *See* Allen et al., *supra* note 16; Fisher, *supra* note 16; SCHRAMM ET AL.,

There can be significantly different legal consequences to homeowners depending on when in the default process the foreclosure is abandoned or what state the homeowner lives in. The case-specific information contained in this paper is from Indiana, a judicial foreclosure state.[31] Some of the negative consequences to be discussed in this paper are only relevant to homeowners who live in a judicial foreclosure state. Others will only affect you if your state allows deficiency judgments. For some, your location does not matter. Thus far, all of the available studies have been conducted in judicial foreclosure states. This may be because the judicial process lends itself to inquiry. You can measure how many cases are filed and how many are followed through to completion. No such records exist in non-judicial foreclosure states. It may also be that the very definition of an abandoned foreclosure requires there to be some kind of "process" that was started and never finished. However, there are also homeowners in default, but for whom no foreclosure has occurred in non-judicial foreclosure states;[32] however, it is harder to document those cases.

Because all the available studies of abandoned foreclosures are from judicial states, the focus of this discussion will be about the implications of these cases in judicial foreclosure settings. The specific procedures for judicial foreclosure vary from state-to-state, but as a general rule, once the homeowner defaults, the lender files a court action, obtains a foreclosure judgment, and then sells the property to satisfy that

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supra note 16; DECIPHERING BLIGHT, *supra* note 16.

[31] There are twenty states in which judicial foreclosure is the usual method of foreclosure: Connecticut (strict foreclosure), Delaware, Florida, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maine, New Jersey (residential properties only), New York, New Mexico (recently amended to allow non-judicial foreclosure in loans after 2006), North Dakota, Ohio, Oklahoma, Pennsylvania, South Carolina, Vermont, and Wisconsin. JOHN RAO ET. AL., NATIONAL CONSUMER LAW CENTER FORECLOSURES: MORTGAGE SERVICING, MORTGAGE MODIFICATIONS, AND FORECLOSURE DEFENSE, App. E, 845-67. (National Consumer Law Center 4th ed. 2012) [hereinafter Foreclosure Defense].

[32] Realty Trac tracks foreclosure filings nationally. They report that the pre-foreclosure inventor rose 59% in the first quarter of 2013. The rise was not exclusive to judicial states, suggesting that the stalled foreclosure is not exclusively a judicial state phenomenon. REALTY TRAC, EXCLUSIVE REPORT: Q1 2013 FORECLOSURE INVENTORY UPDATE 1, 3 (2013), *available at* http://www.realtytrac.com/images/reportimages/RealtyTrac_Foreclosure_Inventory_Analysis_Q1_2013.pdf.

judgment.[33] If there is no buyer at the sale, the bank will often re-purchase the asset.[34] Evidence that a foreclosure can be abandoned at any stage of the process is provided by a review of Irwin Mortgage's foreclosure filings in the doxpop electronic filing system from 2006 and 2007.[35] Of the 157 foreclosures filed by Irwin Mortgage during this period, nearly one third could be categorized as abandoned foreclosures. Twenty-nine were filed and dismissed. Nine cases went to judgment, but the foreclosure sale never occurred. In another nineteen cases, judgment was entered and then vacated by the bank. The Governmental Accounting Office's research concluded that most loans are charged-off before foreclosure is initiated.[36] The situation that has created the most controversy, however, is when the foreclosure action is filed, but abandoned before a foreclosure judgment is entered.[37]

A. Foreclosure Filed and Then Dismissed

It is difficult to calculate the number of borrowers whose loans have simply been charged-off by the bank prior to initiating foreclosure; evidence from the six largest servicers prior to 2010 documents the number at fewer than 20,000.[38] Subsequent studies[39] and anecdotal evidence[40] suggest the phenomenon is far

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[33] *Id.*

[34] The failure of banks to maintain these properties is another serious, related problem. A growing body of evidence suggests that even if they do not walk away from the foreclosure, lenders are walking away from the property. *See generally,* NATIONAL FAIR HOUSING ALLIANCE, THE BANKS ARE BACK—OUR NEIGHBORHOODS ARE NOT: DISCRIMINATION IN THE MAINTENANCE AND MARKETING OF REO PROPERTIES (2012) [hereinafter BANKS ARE BACK], *available at* http://www.nationalfairhousing,org/Portals/33/the_banks_are_back_web.pdf (examining the condition of bank owned properties in seven different communities across the country and finding significant disparities in how the banks maintained properties in majority white as opposed to minority neighborhoods).

[35] Doxpop is an electronic database of court filings available at www.doxpop.com. Docket sheets are available for 82 counties in Indiana. Copies of the case docket are available, though copies of individual filings are not.

[36] GAO-11-93, *supra* note 10, at 16.

[37] Conlin, *supra* note 18.

[38] GAO-11-93, *supra* note 10, at 17.

[39] Allen et al., *supra* note 16, at 16 (concluding that 1/5 of all Florida's

more pervasive. A foreclosure that is never filed, or one that is filed and later dismissed, is a mixed bag for consumers, but it is a better situation for neighbors. The GAO study found that 70% of homeowners remain in their homes if the loan is charged off and foreclosure never initiated.[41]

If foreclosure is initiated, and then dismissed, the numbers drop to only 52%, though still more homeowners remain in their homes than abandon them.[42] Take, for example, the story of Melissa Jones.[43] Ms. Jones and her husband had a stable financial life until Mr. Jones became ill. As his situation deteriorated, Melissa found herself unable to work full time because of the need to be at home to care for her dying husband. When he finally passed away, the decline in her own income coupled with the loss of his disability income drove her into foreclosure. The bank filed a foreclosure action. This foreclosure was initiated early in the foreclosure crisis before any viable programs for loan modification were available for homeowners.[44] When the

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subprime mortgages originated between 2004 and 2008 are at some point "limbo loans."); Fisher, *supra* note 16 (finding that 37% of the cases in her study in Newark, New Jersey were in legal limbo); SCHRAMM ET AL., *supra* note 16 (examining bank walkaways in Cleveland and finding that in 17% of their sample the bank had affirmatively walked away and in another 39% there was an unexplained delay by the bank in the foreclosure); DECIPHERING BLIGHT, *supra* note 16 (finding that abandoned foreclosure increased the likelihood of a property being vacant in Chicago).

[40] For examples of homeowners caught up in abandoned foreclosures, *see* Conlin, *supra* note 18; Susan Saulny, *When Living In Limbo Avoids Living On the Street*, N.Y. TIMES, March 4, 2012, at A14.

[41] GAO-11-93, *supra* note 10, at 17. The study found that in 70% of the cases they looked at where foreclosure had not been initiated, the homeowner was still in the home.

[42] *Id.*

[43] Not her real name. The circumstances of this story and other client stories contained in this article are factual. Unless previously released to the press, I have changed the client's name and inconsequential details to preserve the homeowner's privacy. All parties consented to their stories appearing in this article.

[44] The Hope for Homeowners program was initiated in 2008. It was a voluntary program and widely considered a failure. In the first seven months of the program only one borrower in the entire country had obtained a refinance. McCoy, *supra* note 10, at 10. The Obama administration made changes that did allow more homeowners to be assisted, but many still feel not enough is being done to assist homeowners. *See generally* Alan M. White, *Rewriting Contracts, Wholesale: Data on Voluntary Mortgage Modifications from 2007 and 2008 Remittance Reports*, 36 FORDHAM URB. L.J. 509 (2009);

students at Notre Dame's Economic Justice Project[45] examined the paperwork for the loan foreclosure, they became suspicious. After some investigation and diligent searching, the students located the bank employee who had allegedly signed the documents. More accurately, they found the woman whose name appeared on the paperwork. She had not, in fact, signed them. Instead, someone else had signed her name and she signed an affidavit for the Economic Justice Project attesting to the forgery.[46] When these errors were brought to the bank's attention, they dismissed the foreclosure, with prejudice.[47]

In a study of Florida foreclosures, Allen, Peristianui and Tang, tested whether lost or missing documentation could account for the abandoned foreclosures they discovered in their Florida study.[48] They dubbed this the "operational risk hypothesis."[49] They found that the "greater incidence of foreclosure case dismissals (resulting from legal and operational

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Lynnley Browning, *Distressed Owners Are Frustrated by Aid* Group, N.Y. TIMES (Apr. 2, 2008), http://www.nytimes.com/2008/04/02/business/02hope.html?_r=0; Dawn Kopecki & Theo Francis, *U.S. May Retool Program for Underwater Borrowers (Update 1)*, BLOOMBERG (Jan. 27, 2010, 9:56 AM), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aXET2r166YGU.

[45] The Economic Justice Program is the consumer clinic the author supervises as part of the Notre Dame Law School's Clinical Law Center. Students, usually in their final year of law school, represent low and moderate-income clients against foreclosure and related debt collection.

[46] These documents are on file with the author. This occurred years before the robo-signing scandal became news. At the time, no one had heard of robo-signing. Now we know that such occurrences were common in the industry. *See generally* DAVID H. CARPENTER, CONG. RESEARCH SERV., RL 41491, "ROBO-SIGNING" AND OTHER ALLEGED DOCUMENTATION PROBLEMS IN JUDICIAL AND NONJUDICIAL FORECLOSURE PROCESSES 14 (2010) [hereinafter ROBO-SIGNING].

[47] A dismissal with prejudice would mean the lender cannot re-initiate the foreclosure filing. However, the Indiana Court of Appeals, in *Afolabi v. Atl. Mort. & Inv. Corp.*, had found there is neither *res judicata* or claim preclusion prevented the lender from initiating foreclosure after a previous foreclosure had been lost in summary judgment. Afolabi v. Atl. Mort. & Inv. Corp, 849 N.E.2d 1170, 1173 (Ind. Ct. App. 2006). Each missed payment triggers a new default and a new right to foreclose. *Id.* While the facts in Ms. Jones's case are distinguishable, it was not entirely clear that the bank could not re-file the foreclosure.

[48] Allen et al., *supra* note 16, at 5.

[49] *Id.* at 17.

problems) is associated with a greater likelihood that a loan remains in limbo."[50] Similarly, the Governmental Accounting Office found that "[t]he vast majority of abandoned foreclosures were loans that involved third-party investors including those that were securitized into private label [mortgaged-backed securities]."[51]

Interestingly, the evidence from Florida also found that "the presence of MERS[52] makes a delinquent loan more likely to end up in limbo."[53] Melissa's loan was a MERS loan as well. The theory behind the MERS system is that MERS acts as the registered mortgage holder, allowing the mortgage to be sold while MERS maintains records of the equitable owner.[54] Unfortunately, the theory failed to translate well into practice and research shows that MERS has not operated as intended..[55] In theory, one of two things should have occurred. Either the originating lender should have prepared "a blank mortgage assignment to be filled in later in the event that recording the assignment became necessary for foreclosure purposes"[56] or MERS should have recorded the mortgage in its name as "nominee" and then kept track of the beneficial owner.[57] However, Professor White presents a third option, which was to "take neither step, so that when foreclosure becomes necessary, the servicer is forced to obtain an assignment (or perhaps fabricate one) from the original lender to the current owner."[58]

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[50] *Id.* at 28 (finding that "one-standard-deviation increase (14.2%) in dismissals is associated with a 9.4% increase in the probability that the loan remains in limbo.")

[51] GAO-11-93, *supra* note 10, at 28.

[52] MERS is the Mortgage Electronic Registry System. It was created to allow for the easy buying and selling of loans by "eliminating the need to record each mortgage assignment in county property records." Alan M. White, *Losing the Paper-Mortgage Assignments, Note Transfers and Consumer Protection*, 24 LOY. CONSUMER L. REV. 468, 486 (2012); *See generally* Commission *Report,* supra note 2, at 407 (explaining how standing problems with MERS exacerbated the foreclosure problems); Christopher L. Peterson, *Two Faces: Demystifying the Mortgage Electronic Registration System's Land Title Theory*, 53 WM & MARY L. REV. 111 (2011) (describing MERS and its purpose, creation, and the problems it created in the land recording system).

[53] Allen et al., *supra* note 16, at 28.

[54] White, *supra* note 52, at 486.

[55] *Id.* at 485-88.

[56] *Id.* at 485.

[57] *Id.*

[58] *Id.*

This is exactly what happened in Melissa's case. When the lender wanted to foreclose, the servicer did not have the paperwork. The original lender had been out of business for several years. An assignment was fabricated, ultimately resulting in the foreclosure being dismissed. Considering the many paperwork problems discovered in relation to securitized loans,[59] it is not surprising that these loans would be disproportionately abandoned.

Dismissal in a mortgage foreclosure may seem like a good result for a homeowner, but in many ways it is not. After the dismissal, Melissa was in legal limbo. She made multiple attempts to contact the bank to negotiate ways to pay back the loan, but the bank had charged-off the loan so they would not discuss repayment with her. She did not have a clear title to facilitate a sale. The Economic Justice Project filed a quiet title action and was able to permanently remove the mortgage lien from her property. Removing the mortgage, however, does not solve the entire limbo loan problem. The original note, if it exists, can still be enforced against the homeowner.[60] Indiana follows the common law rule that the mortgage follows the note.[61] Granted, the mortgage was extinguished in the quiet title action, but this is such an unusual situation that it is hard to predict what a court might do with these facts. If the note ever re-appears, Melissa will owe a huge debt that she cannot possibly pay off.

A *pro se* petitioner will likely have trouble succeeding on, let alone filing, a quiet title action. Most consumers in foreclosure are unrepresented[62] and, therefore, will be unable to remove the

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[59] *See generally* White, *supra* note 522 (describing many of the paperwork problems that appeared during the foreclosure crisis); ROBO-SIGNING, *supra* note 466, at 9 (describing how robo-signing and other issues manifest themselves in judicial foreclosure states).

[60] IND. CODE ANN. § 26-1-3.1-301 (West 2013). *See also* Douglas J. Whaley, *Mortgage Foreclosure, Promissory notes, and the Uniform Commercial Code*, 39 W. ST. U. L. REV. 313, 320–23 (2012) (explaining the general relationship between the note, the mortgage, and the Uniform Commercial Code in foreclosure); Elizabeth Renuart, *Uneasy Intersections: The Right to Foreclose and the UCC,* 48 WAKE FOREST L. REV. 5 (forthcoming, 2013) (explaining extensively the relationship between the UCC and foreclose in the context of different state jurisprudence).

[61] This was codified in the IND. CODE ANN. § 26-1-9.1-203(g) (West 2013). *See generally* Whaley, *supra* note 60, at 320–23 (explaining the merger doctrine and the common law rule the "the mortgage follows the note").

[62] MELANCA CLARK & MAGGIE BARRON, BRENNAN CENTER FOR

mortgage lien from their home. If these homeowners need to move for business or personal reasons, their only option is to abandon the home.

B. Foreclosure Filed, Then Stalled

Another category of borrowers are those for whom home foreclosure was filed in court, but not prosecuted to completion. These might best be called "stalled," as opposed to abandoned, foreclosures. Some of these foreclosures are stalled because the lender cannot locate the proper paperwork,[63] while others are in the endless loop that has become loss mitigation,[64] and an undetermined number are bundled into new securities and sold back into the secondary market, often along with performing mortgages.[65] Some lenders may simply be waiting for the economy to improve before proceeding. This is what happened to Nick, another client of the Economic Justice Project.

Nick was sued for foreclosure in May 2010.[66] At the time he was unemployed and did not qualify for a loan modification. He resigned himself to losing the house and put it up for sale. He was unable to find a buyer. He tried unsuccessfully to contact the bank. Nearly three years passed and then, unexpectedly, the bank asked the court to enter a foreclosure judgment. A new servicer was involved.[67] Nick is now working and can afford to make payments. He is attempting to work with the bank to retain the home. This case is likely to have a happy ending; or is it?

A stalled foreclosure case raises a number of problems for

JUSTICE, FORECLOSURES: A CRISIS IN LEGAL REPRESENTATION 2 (2009) (documenting the lack of legal representation in foreclosure cases and the negative ramifications for homeowners).

[63] David Streitfeld, *Foreclosures Slow as Document Flaws Emerge*, N.Y. TIMES, Oct. 1, 2010, at A1.

[64] *See generally* Commission Report, *supra* note 2, at 405; McCoy, *supra* note 10, at 47.

[65] FEDERAL TRADE COMMISSION, THE STRUCTURE AND PRACTICES OF THE DEBT BUYING INDUSTRY T-5 (Jan, 2013).

[66] Cause No. 71-D07-1005-MF-00411, St. Joseph Superior Court.

[67] The loan may also have a new owner, which would explain some of the long delay. The homeowner never really knows who "owns" the loan. They only know who is servicing the loan. This is a frustration for the homeowner and complicates workout options. Servicers claim restrictions to modification that may or may not be true and most homeowners have no way to verify the claims.

the homeowner. Three years of interest and fees can substantially increase the balance due on a mortgage.[68] It exacerbates the problem many homeowners already experience: that they owe more on the home than the home is worth. Faced with this dilemma, some may choose to walk away from the property.[69]

The buying and selling of these distressed mortgage assets has become big business, again suggesting the number of these nonperforming loans is not small.[70] Some of these buyers are willing to work with homeowners; others are looking to foreclose and flip the property.[71] It is hard to know which is more

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[68] Some have argued that this is a deliberate attempt to increase fees for the servicers. S*ee* McCoy, *supra* note 10, at 41–44 (for an explanation of the fee structure associated with mortgage servicing).

[69] And now we have come full circle. Those who may not have strategically defaulted, strategically choose to give up attempts to save the home when faced with the growing balance due. The industry has doggedly resisted any principal write downs to save homes from foreclosure, even when the "principal" is really capitalized interest and fees.

[70] John Collins Rudolf, *Auctions for Troubled Property Loans Jump to the Web,* N.Y. TIMES, Apr. 25, 2009, at B1; Janet Morrissey, *New REITs Pounce on Distressed Mortgage Assets*, TIME (Aug. 18, 2009), http://www.time.com/time/printout/0,8816,1916998,00.html#; Carolyn Said, *Vulture investors buy up distressed mortgages*, S.F. CHRON. (June 7, 2010, 4:00 AM), http://www.sfgate.com/business/article/Vulture-investors-buy-up-distressed-mortgages-3262447.php.

[71] HUD, when announcing its Distressed Asset Stabilization Program, highlights the fact that purchasers will be able to modify loans and still make money because of the low cost of the loan. U.S. DEP'T OF HOUS. & URBAN DEV. HUD NO. 12-116, HUD ACCEPTING APPLICATIONS FOR ENTITIES TO PURCHASE TROUBLED MORTGAGES, OFFER CHANCE TO AVOID COSTLY FORECLOSURES AND STABILIZE NEIGHBORHOODS (July 18, 2012) [hereinafter HUD No. 12-116], http://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2012/HUDNo.12-116. *But see* NATIONAL CONSUMER LAW CENTER, FHA'S DISTRESSED ASSET SALES AND LOSS MITIGATION SHOULD BE REFORMED TO MAXIMIZE SUSTAINABLE HOMEOWNERSHIP SOLUTIONS (Aug. 31, 2012) [hereinafter FHA REFORM], *available at* http://www.nclc.org/images/pdf/foreclosure_mortgage/mortgage_servicing/fha hud-%20asset-sales%20issue-brief31aug2012.pdf (calling on HUD to require investors who purchase the loans to comply with HUD loss mitigation rules); NATIONAL CONSUMER LAW CENTER, FHA'S DISTRESSED ASSET SALE PROGRAM SHOULD STRENGTHEN HOME RETENTION GOALS (Dec. 26, 2012) [hereinafter HOME RETENTION GOALS], *available at* https://www.nclc.org/images/pdf/foreclosure_mortgage/mortgage_servicing/fha-loan-sales-12262012.pdf (recommending changes in the distressed asset sale that provide more accountability and transparency).

beneficial to the economy; occupied homes are usually better than vacant properties, but homeowners whose loans are sold to investors can be left in uncertain and often expensive situations.

C. Foreclosure Abandoned After Judgment, Pre-sale

Troubling stories have surfaced concerning homes that were foreclosed, but never sold to satisfy the judgment.[72] Mercy is one such mortgage holder.[73] In 2007, the Economic Justice Project represented almost exclusively mortgage defense clients. Mercy came in for assistance with a property issue that did not seem to fit the typical foreclosure profile. The Project's student intern and I almost turned her away. Had we done so, I would not be writing this article. Mercy's case first made me aware of the devastating effects of bank walkaways.

Mercy was a recent immigrant, unsophisticated in American real estate practice. A local real estate investor convinced her that the way to succeed in America was through land speculation. She and several other recent immigrants were persuaded to purchase several rental properties.[74] In one day, through one closing, Mercy signed closing documents for ten loans, several with the same bank. All the properties were rental properties, allegedly occupied with tenants. As it turned out, none of the properties had tenants and most were not habitable. The loan documents she signed accurately reflected her poverty-level income and lack of knowledge in real estate management. However, she never saw the documents submitted to the banks.

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[72] *See* Conlin, *supra* note 18 (describing what she dubs the "zombie title" as a situation where the homeowner thinks his or her home was lost in foreclosure, only to discover the bank never took title and there are thousands of dollars of fees owed to local governments); Podmolik, *supra* note 19 (discussing the problems loan walkaways are creating for municipalities); Saulny, *supra* note 19 (explaining the story of loans abandoned after judgment).

[73] *See* Saulny, *supra* note 19 (featuring Mercy in one of the early stories of bank walkaways).

[74] The perpetrators of this fraud were eventually convicted in federal court in three separate cases for their role in the scheme. United States v. Sheneman, No. 3:10-CR-00120 (01), WL 2906859 (N.D. Ind. July 16, 2012). *See also* Mary Kate Malone, *Elder Sheneman gets eight years in South Bend mortgage fraud scheme*, SOUTH BEND TRIB. (Sept. 14, 2011), http://articles.southbendtribune.com/2011-09-14/news/30158261_1_superior-mortgage-lending-tri-state-mortgage-mortgage-fraud-scheme.

Unsurprising, all the properties fell into foreclosure almost immediately.[75]

Interestingly, it was not one of these foreclosures that brought Mercy to my office, but a notice from the City of South Bend informing her that one of her properties was in violation of city building codes. Mercy was confused. Two years earlier, she had appeared in St. Joseph Superior Court and agreed to the foreclosure and sale of this property.[76] When Mercy came to my office, she brought a copy of the notice for sheriff's sale. She had abandoned the property prior to the June 2007 sale date, and had not visited the property since. We were sure there had been a mistake and contacted the city to explain that Mercy no longer owned the property. We were wrong. The bank had filed the foreclosure. Mercy had, in fact, appeared in court and agreed to the entry of a judgment. The judgment had been entered, just as she remembered. The bank had requested a sheriff sale and a date had been set. Notice of that sale was sent to Mercy, as required by Indiana law.[77] What Mercy did not know was that the sale never occurred. The bank cancelled it, presumably because it determined that the home was not worth selling. Mercy did not receive notice that the sale had been cancelled because no such notice is required by Indiana law. The property remained in Mercy's name; therefore, she remained legally responsible for the maintenance.[78] Unfortunately for Mercy, the city and her former neighbors, she had no knowledge of this obligation. The property had been uninhabited for a year and in that time vandals had stolen nearly everything of value, including the copper pipes and appliances. Eventually, the property was demolished.

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[75] Cause No. 71-CO1-0605-MF-00430; 71-C01-0605-MF-00441; 71-CO1-0605-MF-00440; 71-DO1-0606-MF-00611; 71-CO1-0606-MF-00497 ; 71-DO7-0606-MF-00557; 71CO1-0606-MF-00483; 71DO5-0807-MF-00723; 71DO6-0605-MF-00484. The mortgage on the tenth property has not been paid in many years, though no foreclosure has been filed. The property is not habitable.

[76] Judgment was entered on 7/10/2006. The sale was set for 6/21/2007. 71-D07-0696-MF-00557.

[77] IND. CODE ANN. § 32-29-7-3(c) (West 2013).

[78] Under Indiana law, the home remains in the name of the homeowner until sheriff's sale. The foreclosure judgment allows the bank to petition for the sale, but it does not divest the homeowner of ownership of the property. IND. CODE ANN. § 32-29-7-11 (West 2013). In normal times, this was a good thing. In the era of abandoned foreclosures, it has become a nightmare for many homeowners.

Mercy's story is all too common.[79] Through conversations with the City of South Bend's code enforcement office, we discovered that this "happens all the time."[80] A special report by Reuters documented homeowners in Columbus, Ohio, Cleveland, Ohio and Buffalo, New York facing similar circumstances.[81] The number of cases in front of Cleveland Housing Court Judge Raymond Pianka involving "derelict properties" has doubled in recent years, "due largely to homes vacated by people who fled before an imminent foreclosure sale, only to learn later that they remain legally responsible for their house."[82] A Woodstock Institute study of vacant properties in Chicago found that homes were more likely to become vacant when foreclosure was initiated, but not followed through to sale.[83] This situation can create different problems, depending on the laws in your particular community. In Cleveland, the homeowner can find herself facing multiple fines and court costs. In Mercy's hometown of South Bend, Indiana, the number of these cases has doubled since 2006.[84]

III. THE REAL "ZOMBIE TITLE"

Michelle Conlin of Reuters coined the term "zombie title" to explain these uncompleted foreclosures.[85] While the homeowners she described as having "zombie titles" faced significant problems, a truer form of "zombie title" has entered the market—a home that is foreclosed, never set for sale, and then "un-foreclosed" by the lender. The note and mortgage are inexplicably re-born.

It is hard to determine how many of these "zombie titles" are really lurking in the shadows of the mortgage industry. Foreclosure is a state court process and there is no efficient way

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[79] Conlin, *supra* note 18.

[80] Interviews with Ann Carol Nash and Cathy Toppel, City of South Bend, March 3, 2009.

[81] Conlin, *supra* note 18.

[82] *Id.*

[83] DECIPHERING BLIGHT, *supra* note 16, at 3.

[84] *Id.*

[85] Conlin, *supra* note 18. "Zombie title" is an obvious reference to the term "zombie debt", which has become widely recognized in the debt collection world as referring to debt that is very old, usually beyond the statute of limitation or already discharged in bankruptcy that is seemingly re-born by a debt collector who aggressively works to collect.

to search court filings to determine the number of cases where a foreclosure judgment was entered and subsequently set aside.[86] Indiana does not have an online filing or records system, although approximately one half of Indiana's counties record their docket sheets in an online docket system, doxpop.[87] A search from January 1, 2009 to July 1, 2011 revealed hundreds of cases where the judgment was set aside, but did not reveal much about why the judgment was set aside. Judge Manier, a St. Joseph County Superior Judge, reports a recent increase in the number of requests to set aside foreclosure judgments.[88] In a study of abandoned foreclosures in Cleveland, researchers categorized 17% of the loans in the sample as loans where the bank had either set aside a previously awarded judgment or notified the court it did not want to proceed.[89] In the vast majority of cases, no reason was given for the motions to vacate or dismiss.[90] In her study of Newark, New Jersey foreclosures, Linda Fisher also found evidence of judgments that were being set aside.[91] These additional findings are consistent with mine. I am, therefore, confident in stating that banks are going back into foreclosure cases and setting aside previously entered foreclosure judgments.

I am less confident stating one definitive reason for the practice. A review of files in St. Joseph, LaPorte, Allen and Elkhart counties suggests some reasons, but it is impossible to state one definitive cause for this phenomenon. Lenders tend to give vague or nonexistent reasons for seeking to vacate a judgment.[92] A closer examination of some of the files illustrates

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[86] *State Court Caseload Statistics*, COURT STATISTICS PROJECT (last visited September 9, 2013), http://www.courtstatistics.org/Other-Pages/stateCourtCaseloadStatistics.aspx.

[87] DOXPOP, http://www.doxpop.com/ (last visited September 26, 2013).

[88] Hearing Transcript at 12-13, JP Morgan Chase v. Pinckert, No. 71D05-1208-MF-00529 (St. Joseph Cnty., Ind. Super. Ct. Aug. 27, 2013) [hereinafter Hearing Transcript].

[89] SCHRAMM ET AL., *supra* note 16, at 7.

[90] *Id.*

[91] Fisher, *supra* note 16, at 37-38.

[92] SCHRAMM ET AL., *supra* note 16, at 7. (In one case the study cites the lender moved to set aside the judgment because "the parties had resolved the matter." When the judge inquired further, the bank admitted that the parties had not resolved the matter. The low equity in the property was the real reason for setting aside the judgment.). In my review of files, language implying the parties had settled was common. In every case that the judge inquired, it turned out to be untrue. *See infra* Part II.C.

the difficulty in determining the real motivation behind these zombie loans.

A. The Doctrine of Merger and its Implication in the Selling of Distressed Mortgages

Donna had what I would characterize as an abandoned mortgage, not a "zombie title."[93] However, her story best explains how a mortgage loan might move from being simply abandoned to being re-born as "zombie title." When Donna came to the Economic Justice Project for assistance, her home had already been foreclosed.[94] In the ensuing two years, the house had fallen into disrepair. Donna had been surprised to receive a complaint for a second foreclosure proceeding on the same mortgage note. She did not have a second mortgage, nor did she recognize the name of the company that was foreclosing. We later determined it was an investor. The investor claimed it had purchased the note from the lender. The lender, likewise, appeared and claimed it had sold the note and mortgage to the investor after entry of the judgment.

The doctrine of merger makes the lender's and the investor's understanding of the situation legally impossible. According to this longstanding doctrine, when a judgment is entered the underlying claim merges into that judgment.[95] In a foreclosure, the underlying claim would be the note and the

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[93] Donna has agreed to let us discuss her situation, but requested to protect her anonymity. The specifics of this case are not as important as the legal implications. Therefore, I am not providing the file numbers and parties' names in order to obscure her identity. The records are public and on file with the St. Joseph Superior Court.

[94] Because of a prior foreclosure, the judgment was "in rem" and did not, as is customary in Indiana, include a personal judgment on the note.

[95] RESTATEMENT (SECOND) OF JUDGMENTS § 18 cmt. a (1982). *See* In re Schlect, 36 B.R. 236, 240 (Bankr. D. Alaska 1983) (finding promissory note had merged into the foreclosure judgment previously entered in state court and, therefore, the provision in that note that allowed for the payment of attorney's fees did not apply in the bankruptcy court); Caine & Weiner v. Barker, 713 P.2d 1133, 1134 (Wash. Ct. App. 1986) (judgment awarded against two signers of a promissory note; when one paid the debt and then tried to obtain attorney's fees provided for in the note from the second debtor, the court found that the note had merged into the judgment); *But see* In re Gayle, 189 B.R. 919, 920 (Bankr. S.D. Tex. 1995) (bank foreclosed in a non-judicial proceeding and then obtained a separate court judgment on the note; the court held that the doctrine of merger did not preclude a bank from pursuing the foreclosure).

mortgage, both of which merge into the foreclosure judgment once it is entered. Simply put, when the lender allegedly sold this note to an investor, there was no promissory note to sell. There was only a judgment.

This case eventually came to a satisfactory conclusion as the bank agreed to assign its judgment to the investor. Procedurally, this is what the bank should have done if it wanted to charge-off the loan after the judgment was entered. The assignment of judgment allowed the investor to proceed with the sheriff's sale. The investor ultimately took possession by bidding the judgment amount at the sale.

This case illustrates several important issues for discussion. First, it suggests that at least some of the underlying loans connected to the abandoned foreclosures are being sold on the secondary market. It also appears these sales may occur despite the fact that there is no longer a promissory note to sell.[96] Of course, the experience of one homeowner does not prove a pattern; though it does provide evidence for one. Additional evidence is found in the fact that throughout the process, the investor, the mortgage servicer, and their legal representatives failed to understand the doctrine of merger and the legal implications of the prior foreclosure judgment. As a result, judicial resources and attorney time were wasted. This experience left my students and me with few doubts that this has occurred to other, unrepresented homeowners and helps to explain why some lenders may be seeking to vacate judgments, thereby creating a "zombie title."

1. Trial Rule 60

The doctrine of merger makes it favorable for the lender to set aside the mortgage judgment when it wants to sell a nonperforming mortgage loan. Because these loans were judicially foreclosed, a lender must return to court to set aside the judgment. How and when that can be accomplished is governed by the rules of civil procedure. Most courts follow either Rule 60 of the Federal Rules of Civil Procedure or a close variation of it.[97] Indiana's trial rule, while not identical, is the same as the federal

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[96] *See infra* Part III for a discussion on how the industry seems to be working around this problem.

[97] FED. R. CIV. P. 60.

rules in terms of the issues relevant to this discussion.[98] It is unusual for the prevailing party to seek to set aside a judgment, therefore the decisions discussing this issue are almost exclusively concerned with not prejudicing the party for whom the judgment was entered. The courts seem to assume that setting aside a judgment will always be a good thing for the losing party. The concept of a "zombie title" challenges that assumption.

One of the most troubling aspects of the "zombie title" is the fact that lenders rarely supply reasons, let alone accurate ones, to support a motion to vacate a foreclosure judgment. Furthermore, lenders virtually never cite the relevant portion of the law to support such a motion. A judgment can be set aside for a number of reasons, including "mistake, surprise or excusable neglect."[99] The usual parties to a mortgage foreclosure action are the homeowner, who in this case was already informed his home was foreclosed, and the loan servicer, who now wants to un-foreclose the loan. None of the files I reviewed mention "mistake, surprise or excusable neglect"[100] as a reason to support the motion to vacate judgment, nor do any of the reports of other studies mention this as a reason for setting aside a judgment.

A judgment may also be set aside for "fraud" or "newly discovered evidence".[101] Again, no lender cited these as reasons to set aside the judgment. The most common reason stated in motions to set aside judgment was language implying that a settlement had been reached.[102] Examples include: "all matters in controversy have since been settled"[103] and "the subject matter of

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[98] IND. TRIAL R. 60. Both rules allow for the correction of clerical errors and require the motion be filed within one year when claiming "mistake, surprise or excusable neglect, newly discovered evidence or fraud." FED. R. CIV. P. 60(b)(1), (b)(2), (b)(3); IND. TRIAL R. 60(B)(1), (B)(2), (B)(3). Both rules also allow litigants to file a motion within a reasonable time for three additional reasons: "the judgment is void", "the judgment has been satisfied, released or discharged," and "any other reason" justifying relief. FED. R. CIV. P. 60(b)(4), (b)(5), (b)(6); IND. TRIAL R. 60. 60(B)(6), (B)(7), (B)(8). The Indiana rule includes additional reasons for setting aside a default judgment for lack of proper notice and judgments involving guardians or representatives. IND. TRIAL R. 60(B)(4), (B)(5).

[99] FED. R. CIV. P. 60(b)(1); IND. TRIAL R. 60(B)(1).

[100] FED. R. CIV. P. 60(b)(1); IND. TRIAL R. 60(B)(1).

[101] FED. R. CIV. P. 60(b)(2), (b)(3); IND. TRIAL R. 60(B)(2), (B)(3).

[102] FED. R. CIV. P. 60(b)(5); IND. TRIAL R. 60(B)(7).

[103] *See, e.g.*, Motion to Set Aside Judgment, HSBC Bank USA, N.A. v. Harvell, No. 20C01-1205-MF-00355 (Elkhart Cnty., Ind. Cir. Ct. DATE)

this present litigation is no longer at issue."[104]

One motion stated that because the loan had been charged-off, the lender wanted to set it aside.[105] While not a valid reason under Trial Rule 60, it was at least an honest one. The judge denied the motion.[106] Most of the files contain no information about how the homeowners reacted to these motions because servicers rarely notify homeowners of the decision to charge-off the loan.[107] The lack of notice to other parties was consistent in all the motions to vacate judgment I examined. When notice is given, it is often to the already abandoned property address. Occasionally a court sets the matter for hearing on its own initiative.[108] That is when things get interesting.[109]

Unfortunately, there is evidence that at least some of the stated reasons for setting aside the judgment are not truthful. In the Cleveland study, for example, the investigators discuss one lender who claimed that "the parties had resolved the matter" and, therefore, the foreclosure judgment should be set aside.[110] When questioned by the Court, the lender admitted that the real reason it wanted to set aside the judgment was the lack of equity in the property.[111] Settlement is a valid reason to set aside a judgment, so long as the motion is brought within a reasonable time.[112] Claiming there is a settlement when there is not a settlement so that you can earn more money is never a permissible reason to vacate or set aside a judgment.

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[104] Motion to Set Aside Judgment and Decree of Foreclosure and to Dismiss Complaint to Foreclose Mortgage, Chase Home Fin., LLC v. Moore, No. 02D01-0901-MF-66 (Allen Cnty., Ind. Super. Ct. Dec. 8, 2010).

[105] Motion to Set Aside Judgment and Dismiss Lawsuit, Without Prejudice, JPMorgan Chase Bank, N.A. v. Yusuph, No. 71-D05-0907-MF-00671 (St. Joseph Cnty., Ind. Super. Ct. filed Apr. 12, 2010) [hereinafter Yusuph Motion to Set Aside Judgment].

[106] *See infra* Part II.A.2. for further discussion of this case.

[107] Abandoned Foreclosures, *supra* note 17, at 38.

[108] *See, e.g.*, Hearing Transcript, *supra* note 88, at 3. Unfortunately, in most cases notice is sent to an already vacant property.

[109] *See* discussion *infra* notes135-153 and accompanying text.

[110] SCHRAMM ET AL., *supra* note 16, at 7.

[111] *Id.*

[112] OHIO R. CIVIL P. 60. The motions to set aside default I discovered in Indiana were filed between a few days after the judgment was entered to six years after judgment.

2. Agreed Judgments, "In-rem" Judgments

A disturbing subset of these cases involves motions to vacate that seek to set aside an agreed, "in-rem"[113] judgment of foreclosure. This came to my attention early in my research when I stumbled upon *JPMorgan Chase Bank, N.A. v. Yusuph*, a case filed in 2009.[114] The pleadings indicate that at the time of this foreclosure the home was in serious disrepair.[115] The City of South Bend entered the case because it had a pending repair order against the property for violations of the Unsafe Building Act.[116] An agreed, "in rem" foreclosure judgment was entered in December 2009.[117] In April 2010, Chase filed a motion to set aside the judgment because the bank had "charged off this mortgage loan account."[118] Neither the homeowner who had defaulted, nor the City which had agreed to the entry of the judgment, were notified of the motion.[119] The bank did not request a hearing.

The judge originally signed an order vacating the judgment.[120] However, the judge reconsidered and set the matter for hearing.[121] After the hearing, the judge entered an order

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[113] An "in rem" judgment can only be satisfied with the proceeds from the sale of the home. No personal liability attaches to the homeowner.

[114] It should be noted that the affidavit filed in support of the judgment in this matter was clearly a stamped signature. Exhibit A, Motion for Default Judgment Entry and Decree of Foreclosure, *Yusuph*, No. 71-D05-0907-MF-00671 (filed Nov. 4, 2009). This case was decided before Chase halted its foreclosures for a period of time in September 2010 in response to robo-signing accusations. *See generally*, ROBO-SIGNING, *supra* note 46, at 1 (for a description of the robo-signing scandal).

[115] Answer, *Yusuph*, No. 71-D05-0907-MF-00671, (filed July 16, 2009 by the City of South Bend, Indiana) [hereinafter Yusuph Answer].

[116] IND. CODE ANN. §36-7-9-26 (West 2013).

[117] Agreed Judgment and Decree of Foreclosure, *Yusuph*, No. 71-D05-0907-MF-00671 (Dec. 17, 2009). An "in rem" foreclosure judgment in Indiana is judgment that can only be executed against the secured property that was subject to the foreclosure. Lenders have the option to also ask the court a personal judgment that can be collected against any other assets of the defendant. In this case, the bank only requested an "in rem" judgment.

[118] Yusuph Motion to Set Aside Judgment, *supra* note 105.

[119] While it is hard to prove a negative, there was no proof of service attached to the motion, nor was there a notice of hearing in the court file.

[120] Order Setting Aside the Judgment and Dismissing the Lawsuit, Without Prejudice or Consent, *Yusuph*, No. 71-D05-0907-MF-00671 (filed April 12, 2010).

[121] Order, *Yusuph*, No. 71-D05-0907-MF-00671 (setting hearing for December 7, 2010). The court cites the "extent to which the Motion to Vacate

reinstating and confirming the judgment.[122] It was the correct decision in this circumstance as setting aside a default judgment is much different than setting aside a judgment that had been agreed to by the parties. It is well recognized in Indiana that "after entering an agreed judgment the trial court has no authority to modify or change the judgment in any essential or material way."[123] In the JP Morgan case described above, the homeowner had been defaulted but the City of South Bend, also a defendant, had participated in the case and signed the agreement for an "in rem" only judgment against the homeowner.[124]

While there is no conclusive evidence as to why the bank sought to set this judgment aside, there are a number of clues in the case files. First, the property was in serious disrepair. There were pending orders to repair this property that had apparently been ignored.[125] The typical procedural step after a foreclosure would be to set the property for sheriff's sale.[126] However, the property had already been dubbed "unsafe" by an administrative proceeding of the city.[127] As a result, it was highly unlikely that anyone would purchase the property because, if they did, they would become responsible for the repairs. Accordingly, if the bank purchased the property in the sale—the usual procedure when there are no other bidders—it would be left to make the

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Judgment and Dismiss the case compromises Defendant's agreement to entry of an in Rem Judgment" as the reason for setting the hearing.

[122] Order, JP Morgan Chase Bank v. Yusuph, No. 71-D05-0907-MF-00671 (reinstating and confirming the judgment).

[123] Wagler v. West Boggs Sewer District, Inc., 980 N.E.2d 363, 376 (Ind. Ct. App. 2012). This principal is not confined to Indiana. Most states follow this rule. *See, e.g.,* Bryan v. Reynolds, 123 A.2d 192 (Conn. 1956) (stipulated judgments cannot be set aside unless it is shown they were obtained by fraud, duress, accident or mistake); Westfall v. Wilson, 467 P.2d 966 (Or. 1970) (consent judgments can only be changed by agreement of all parties); Laffin v. Laffin, 760 N.W.2d 738 (Mich. Ct. App. 2008) (consent judgments cannot be modified absent fraud, mistake or unconscionable advantage); Baran v. Baran, 72 A.2d 623 (Pa. Super. Ct. 1950) (consent decree can only be reviewed if obtained by fraud or based on mutual mistake).

[124] Agreed Judgment and Decree of Foreclosure, *Yusuph*, No. 71-D05-0907-MF-00671 (filed Dec. 17, 2009). The city of South Bend was defendant because of fines and other actions to the property as a result of its being abandoned.

[125] Yusuph Answer, *supra* note 115.

[126] IND. CODE ANN. §32-29-7-3 (West 2013).

[127] Yusuph Answer, *supra* note 115.

repairs. Therefore, it is not surprising that the bank decided this asset was not worth acquiring and never set the sale.[128]

As discussed previously, lenders appear unconcerned with simply walking away from foreclosures when it is not economical to proceed. Doing so requires no affirmative action and, at least currently, violates no laws.[129] What made this loan different? For one, it was an "in rem" judgment.[130] The lender's recovery was limited to the amount it could receive from the sale of the property, and the difference between the sale amount and the amount of the loan would be lost. The lender would not be able to sell the property without making substantial repairs and, even then, it was not likely to recover the entire amount of the loan.[131] The reason the lender articulated for asking the court to set aside the judgment was that the bank had charged off the loan.[132] The fact that a debt has been charged off is usually a reason to seek judgment from the court, not a reason to set one aside. That is, of course, if the creditor intends to collect on that judgment. In this circumstance, Chase could not realistically collect on the debt. They had not obtained a personal judgment, so they could not attempt to collect against the homeowner's wages or other assets. The home, as mentioned previously, was not likely to sell at sheriff's sale.

However, there was one way that the bank could recover some of its loss. It could sell the note. This foreclosure occurred at about the same time that the buying and selling of distressed mortgages was heating up.[133] As Donna's case illustrated, in order

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[128] Numerous allegations were being made at the time that banks were failing to maintain properties it owned in low income neighborhoods. This property was just such a neighborhood. *See generally,* BANKS ARE BACK, *supra* note 34.

[129] GAO-11-93, *supra* note 10, at 16.

[130] Without ordering an expensive transcript, it is impossible to determine why the judgment was in rem. A search of the bankruptcy records does not reveal a bankruptcy, the most common reason for the entry of an "in rem" judgment.

[131] Various on-line websites list the value of this property between $27,600 (trulia.com, last visited September 4, 2013) and $28,327 (zillow.com, last visited September 4, 2013). The judgment entered in December, 2009 showed the homeowner owed $62,597.01, more than double the value of the home in its current, repaired condition.

[132] Yusuph Motion to Set Aside Judgment, *supra* note 105, at ¶ 3.

[133] Janet Morrissey, *New REITs Pounce on Distressed Mortgage Assets*, TIME (Aug. 18, 2009), *available at* http://www.time.com/time/printout/0,8816,1916998,00.html#; Carolyn Said,

to properly bundle this loan with other loans for sale, the note must be un-merged from the judgment.[134] Therefore, the most likely reason the bank sought to set aside the judgment was a desire to sell the note on the secondary market.

A rare hearing that occurred in *JP Morgan Chase v. Pinckert*[135] provides a glimpse of the serious issues these cases raise. The court in *Pinckert* set a hearing on two cases in which the same law firm had filed motions to set aside default judgments.[136] The lender had filed a motion to vacate judgment and to reinstate the note, but apparently did not supply a reason that satisfied the court.[137] The court asked the attorney to explain the reason for the motion.[138] His response was:

> Well, I do, but only in a general sense. Sometimes we get information that will say 'short sale completed' or 'deed in lieu' or something of that nature, or 'loan modification completed.' On both of these, the message that we got . . . And that message just says 'loss mitigation.[139]

The court stated, "I'm not quite sure how to understand a loss mitigation if we may not even have one party," expressing concern that though there were two defendants, Merlin and Ginger Pinckert, Ginger had only been served by publication.[140] After looking through the file, the court informed the attorney that Mrs. Pinckert was deceased.[141] The Court then continued to explore what "loss mitigation" might mean.

Court: You don't know if the term "loss mitigation" is

Vulture investors buy up distressed mortgages, S.F. CHRON. (June 7, 2010), *available at* http://www.sfgate.com/business/article/Vulture-investors-buy-up-distressed-mortgages-3262447.php; Hui-yong Yu & Jason Kelly, *Blackstone Sees Two-Year Window to Buy Houses: Mortgages*, BLOOMBERG (Nov. 14 2012 4:25 PM), http://www.bloomberg.com/news/2012-11-14/blackstone-sees-two-year-window-to-buy-houses-mortgages.html.

[134] *See* discussion of merger, *supra* note 95.

[135] *See* Hearing Transcript, *supra* note 88.

[136] *Id.* at 3. There is no specific information about the second matter. It is simply referred to in the opening of the hearing.

[137] *Id.*

[138] *Id.*

[139] *Id.*

[140] *Id.* at 3-4.

[141] *Id.* at 4.

> used for something other than resolving the matter personally with the borrower?
>
> Attorney: It's my experience it's not for that. I mean, let's put it this way: it's some form of loss mitigation, so it may be—especially given the fact that Miss Pinckert is deceased—it may be a deed in lieu or it may be some type of short sale.
>
> Court: I guess my concern is it doesn't mean that one is mitigating the loss to the financial institution by changing its mind, and rather than foreclosing and having a deficiency judgment and a piece of property you may or may not want, it's now decided to sell this debt to[142]

The attorney misunderstood the judge and interrupts her to explain that the bank does not set aside judgments when it is changing servicers.[143] The court, however, was not concerned about a change in servicer. The court was concerned about a change in ownership. That was clearly not what the court was referencing. The court was clearly expressing a concern about debt buyers, not servicer transfers.

> Court: Yet we seem to be finding—I've had, within the last couple weeks, quite a number of motions to vacate and dismiss. And one attorney said he thought perhaps Fannie Mae had directed this, that they were directing it. But he didn't have a lot more information. My big concern is that someone has walked away from this foreclosure, they may even have gotten an in rem judgment. They've walked away, and they don't necessarily know that the judgment's now been vacated. What, the debt reinstated to be transferred to someone else that's going to seek some other remedy?[144]

The court thus identified the crux of the problem with "zombie titles." When a judgment is set aside and the loan reinstated, it can be transferred to someone else who is likely to pursue another remedy. An "in rem" judgment can easily become

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[142] *Id.* at 4-5.
[143] *Id.* at 5.
[144] *Id.* at 6.

an "in personam" judgment with no notice to the debtor.

At this point, the hearing took a rather bizarre twist. The court asked why the underlying judgment was "in rem."[145] The lawyer claimed the homeowner filed bankruptcy, but as they investigated the file, it turned out to be untrue.[146] However, the lawyer ultimately discovered an agreed "in-rem" judgment in the file:

> Attorney: We have—-we have an agreed entry. We haven't sent that your way. I apologize. It's signed by XXX for Real Services,[147] legal guardian for Merlin Pinckert.
>
> Court: That's not the judgment I signed and it's not been –I don't see that in the file.
>
> Attorney: Merlin Pinckert, right?
>
> Court: So this person is under a guardianship?
>
> Attorney: That's correct.
>
> Court: Not according to anything on the docket sheet or in the file.[148]

The attorney goes on to inform the court that the guardian

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[145] *Id.* at 8.

[146] *Id.*

[147] Real Services is a not-for-profit agency in South Bend that often acts as guardians for indigent senior citizens who are deemed incompetent to manage their affairs. The name of the guardian has been redacted.

[148] Hearing Transcript, *supra* note 88, at 9. If a person is under a guardianship, Indiana Trial Rule 4.2(c) suggests there is a duty to inform the court if one of the litigants is incompetent, the situation if a guardian had been appointed. IND. TRIAL R. 4.2(c). The attorney complained that he did not know there was a guardianship because the dockets are not online in St. Joseph County. Hearing Transcript, *supra* note 83, at 13. The guardianship dockets are online through the Quest system in the St. Joseph Probate Court. In addition, he had already informed the court that the agreement, signed by the guardian, was in the file. *Id.* at 13. Had he looked at the free, online system, the attorney would have seen that the Probate Court had approved the sale of this property on July 23, a month before the hearing in Superior Court. In fact, according to the Probate Court records, 71J02-1111-GU-00220, this property was already sold. The question remains: what was the purpose of the motion to vacate?

had signed an in-rem agreement, but that a different in-rem judgment was submitted to the court.[149]

This is the one and only case in my review where the lender's reason for the motion to vacate and to set aside the judgment was clear:

> Attorney: So once they vacate it [the property in foreclosure], if Mr. Pinckert is in an end-of-life situation, his wife is already deceased, apparently none of his family wants this home, it may fall into disrepair and ultimately become the obligation of the city, which is unfortunate, but –and I know there's been discussions about that in the legislature, but nothing has come of it.
>
> And I think legally my client is entitled; they don't have an obligation in that regard. But that sounds, quite frankly, more likely than loss mitigation.[150]

The attorney in this matter either did not understand or deliberately dodged the judge's question regarding the selling of the note. Though the court clearly understood and questioned the propriety of setting aside an in rem judgment and exposing the debtor to further collection.[151] The lawyer honestly replied that "as a legal matter I don't think that my client is prohibited from doing that."[152] As a legal matter, he may be correct; but as a moral matter, there is likely a different answer.[153]

It is clear that many of these "zombie titles" are being re-sold in the secondary market and it seems that many were sold to PennyMac, a "finance company run almost entirely by alumni of Countrywide Financial."[154] This should be frightening to anyone who has followed the mortgage industry. Countrywide loans were a significant contributor to the mortgage foreclosure crisis.[155]

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[149] *Id.* at 10.

[150] *Id.* at 12.

[151] *Id.* at 7.

[152] *Id.*

[153] A plaintiff or a defendant has the right to set aside a judgment pursuant to Indiana Trial Rule 60. Whether or not the rule is being fully complied with is a major concern.

[154] Stephen Gandel, *Countrywide: It's baaack*, FORTUNE (Oct. 2, 2012, 6:00 AM), http://finance.fortune.cnn.com/2012/10/02/countrywide-is-back-pennymac/.

[155] Commission Report, *supra* note 2, at 248-50.

Below is a very small sample of the loans I discovered illustrating the "zombie loan" pattern:

LENDER	FORECLOSURE JUDGMENT	JUDGMENT SET ASIDE	PENNYMAC FILES FORECLOSURE	JUDGMENT ENTERED
Citimortgage [156]	12/30/2008	1/6/2010	10/10/2012 [157]	2/25/2013 dismissed
Citimortgage [158]	9/2/2010	2/14/2011	1/31/2012 [159]	8/14/2013 foreclosure
Citimortgage [160]	2/4/2009	7/6/2010	9/25/2012 [161]	5/8/2013
Citimortgage [162]	1/24/2011	7/11/2011	5/17/2012 [163]	8/16/2012 dismissed

CHART A: SMALL SAMPLE OF PROPERTIES WITH MULTIPLE FORECLOSURES

In each case a foreclosure judgment was set aside and then the loan was sold to PennyMac, allowing PennyMac to file a new foreclosure action. Not all loans sold to PennyMac fell immediately back into foreclosure. It is not possible to track those loans through the court docket system. Chart A above is a very small sample of cases I discovered where one lender foreclosed, moved to set aside the judgment and then sold the loan. This is representative of the fact that at least some "zombie titles" are

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[156] CitiMortgage v. Luse, No. 91C02-0811-MF-00105 (White Cnty., Ind. Cir. Ct. Dec. 30, 2008).

[157] PennyMac Corp. v. Luse, No. 91C01-1210-MF-000108 (White Cnty., Ind. Cir. Ct. Oct. 10, 2012).

[158] CitiMortgage v. Westover, No. 89D01-0904-MF-052 (Wayne Cnty., Ind. Super. Ct. Sept. 02, 2010).

[159] PennyMac Corp. v. Westover, No. 89D01-1201-MF-00041 (Wayne Cnty., Ind. Super. Ct. I Aug. 14, 2013).

[160] CitiMortgage v. Gillespie, No. 37C01-0912-MF-000634 (Jasper Cnty., Ind. Cir. Ct. Feb. 04, 2009).

[161] PennyMac v.Corp. v. Gillespie, No. 37C01-1209-MF-000934 (Jasper Cnty., Ind. Cir. Ct. May 08, 2013).

[162] CitiMortgage v. Waller, No. 10C01-1101-MF-00036 (Clark Cnty., Ind. Cir. Ct. May 11, 2011).

[163] PennyMac Corp. v. Waller, No. 10C02-1205-MF-000248 (Clark Cnty., Ind. Cir. Ct. Aug. 2, 2012).

being repackaged and resold, either alone or as part of new securities.

The re-securitization of nonperforming loans, especially when they are combined with new loans originated by individuals who contributed so heavily to the last mortgage crisis, should be cause for concern.[164] The securitization of subprime loans was a major contributor to the 2008 economic downturn.[165] Regulators should not allow those loans at the center of the crisis to be simply repackaged and reprocessed. They will re-explode.

B. The Dual Track

It would be both unfair and inaccurate to claim that all efforts to vacate foreclosure judgment are deceptive, inaccurate or done for the sole benefit of the lender. Sometimes the parties really do reach an agreement. Evidence of this was also found in court files. One example is *HSBC Bank v. Harvell*.[166] A complaint for foreclosure was filed on May 7, 2012.[167] The homeowners failed to respond and a default was entered on July 17.[168] On August 9, the lender filed a praecipe asking the sheriff to set the home for sheriff's sale.[169] On August 16, the homeowners sent a letter to the court, explaining that they were seeking a loan modification and had just been asked for another set of documents for the loan servicer.[170] On April 15, 2013, the bank filed to vacate the judgment because the parties had reached an agreement, presumably a loan modification.[171]

The homeowner in this situation was able to stop the foreclosure and the judgment was set aside. It is troubling,

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[164] Gandel, *supra* note 154.

[165] Commission Report, *supra* note 2, at 125. *See generally* ADAM B. ASHCRAFT & TIL SCHUERMANN, FED. RESERVE BANK OF N.Y., UNDERSTANDING THE SECURITIZATION OF SUBPRIME MORTGAGE CREDIT (Mar. 2008).

[166] Chronological Case Summary, HSBC Bank v. Harvell, No. 20C01-1205-MF-00355 (Elkhart Cnty., Ind. Cir. Ct. Sept. 22, 2013) [hereinafter Harvell Case Summary].

[167] *Id.* at 1 (Minute Entry, May 9, 2012).

[168] *Id.* (Minute Entry, July 19, 2012).

[169] *Id.* (Minute Entry, Aug. 9, 2012); IND. CODE ANN. §32-29-7-3 (West 2013).

[170] Harvell Case Summary, *supra* note 166, at 1 (Minute Entry, Aug. 23, 2012).

[171] *Id.* at 2 (Minute Entry, Apr. 17, 2013).

however, how quickly this case proceeded from filing to judgment when the home owner was engaged in loss mitigation. This is symptomatic of the dual tracking problem that has been common in the industry.[172]

Dual tracking is the process by which lenders pursue both loss mitigation and foreclosure consecutively.[173] The homeowner is often told not to worry about the foreclosure process and, as a result, fails to appear in the foreclosure case filed in court. The result is that many homeowners are faithfully working with the bank to save their home, only to learn that a default has been entered and the home foreclosed.[174] Dual tracking has been very controversial.[175]

In April of 2011, Fannie Mae and Freddie Mac bowed to considerable pressure and modified their servicing guidelines.[176] Servicers were instructed not to commence or conclude a foreclosure if loss mitigation was in process.[177] On February 14, 2013, the Consumer Financial Protection Bureau issued rules meant to restrict the practice of "dual tracking."[178] The tragedy is that the restriction is too little too late. Many of the homeowners who faced dual tracking have already lost their homes. Vacating foreclosure judgments that occur in the context of "dual tracking" may actually benefit some homeowners; however, eliminating the practice would benefit many more homeowners.

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[172] Sharon Schmickle & Sarah Rose Miller, *'Dual Tracking' trap: Owners lose homes while trying to modify mortgages*, MINNEAPOLIS POST (Mar. 21, 2013), http://www.minnpost.com/politics-policy/2013/03/dual-tracking-trap-owners-lose-homes-while-trying-modify-mortgages.

[173] *CFPB Rules Establish Strong Protections for homeowners facing foreclosure*, CONSUMER FIN. PROT. BUREAU (Jan. 17, 2013), http://www.consumerfinance.gov/newsroom/consumer-financial-protection-bureau-rules-establish-strong-protections-for-homeowners-facing-foreclosure/.

[174] *Id.*

[175] *See generally*, Schmickle, *supra* note 172; Shahien Nasiripour, *National Mortgage Settlement Review Prompts Dual-Track Discussions With Banks*, HUFFINGTON POST (June 19, 2013), http://www.huffingtonpost.com/2013/06/19/national-mortgage-settlement-dual-tracking_n_3468307.html?view=print&comm_ref=false.

[176] *Frannie Mae and Freddie Mac to Align Guidelines for Servicing Delinquent Mortgages*, FED. HOUS. FIN. AGENCY (Apr. 28, 2011), http://www.fhfa.gov/webfiles/21190/sai42811final.pdf.

[177] *Id.*

[178] Mortgage Servicing Rules Under the Real Estate Settlement Procedures Act (Regulation X), 78 Fed. Reg. 10696 (proposed Feb. 14, 2013) (to be codified at 12 C.F.R. pt. 1024).

C. Distressed Asset Stabilization Program

The number of motions to vacate seems to be increasing.[179] Several recent cases that have come before the St. Joseph Superior Courts raise additional concerns.[180] These cases are significant both because of the reasons articulated for vacating the judgments and the underlying circumstances of each of the homeowners. The first case is *Bank of America, N.A. v. Kimes*.[181] The complaint to foreclose this mortgage was filed on September 17, 2012.[182] Mr. Kimes died of cancer four months earlier on May 18, 2012.[183] A default judgment was entered on May 10, 2013.[184] In July, the bank requested that the judgment be vacated because "the subject matter of this present litigation is no longer at issue."[185] The court questioned how the matter could possibly be resolved in loss litigation when Mr. Kimes was deceased.[186] The attorneys for the bank explained that they were required to set the judgment aside by the U.S Department of Housing and Urban Development's (H.U.D.) Distressed Asset Stabilization Program.[187]

Soon after, a second motion to set aside judgment was filed in *Nationstar Mortgage, LLC v. Estrada*.[188] This foreclosure was filed in 2012.[189] The homeowner failed to respond and a

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[179] *See, e.g.*, Hearing Transcript, *supra* note 88, at 12-13.

[180] *Id.* at 6; Interview with Hon. Jenny Pitts Manier, St. Joseph Cnty. Super. Ct. Judge (Sept. 4, 2013).

[181] *See* Motion to Set Aside Judgment and Decree of Foreclosure and to Dismiss Complaint to Foreclose Mortgage, Bank of America, N.A. v. Kimes, No. 71-D0571D05-1209-MF-00617 (St. Joseph Cnty., Ind. Cir. Ct. July 10, 2012) [hereinafter Kimes Motion to Set Aside Judgment].

[182] *Id.*

[183] Mark Kimes Obituary, PALMER FUNERAL HOMES, http://www.palmerfuneralhomes.com/obits/obituary.php?id=178421 (last visited Oct. 27, 2010).

[184] *See* Kimes Motion to Set Aside Judgment, *supra* note 181.

[185] *Id.* at ¶ 1.

[186] Interview with Hon. Jenny Pitts Manier, St. Joseph Cnty. Super. Ct. Judge (Aug. 14, 2013) [hereinafter Judge Manier Interview].

[187] *Id.*

[188] Motion to Set Aside Judgment and Decree of Foreclosure and to Dismiss Complaint to Foreclose Mortgage, Nationstar Mortgage LLC v. Estrada, No. 71-D05-1212-MF-00787 (St. Joseph Cnty., Ind. Super. Ct. July 19, 2013) [hereinafter Estrada Motion to Set Aside Judgment].

[189] Complaint on Note and to Foreclose Mortgage on Real Estate, *Estrada*, No. 71-D05-1212-MF-00787 (filed Dec. 10, 2012).

default judgment was entered on May 10, 2013.[190] The motion to set aside the judgment also claimed "the subject matter of this present litigation is no longer at issue."[191] Again, the judge inquired as to the real reason for the motion and was again told it was required by HUD or perhaps directed by Fannie Mae.[192]

In July 2012, HUD announced the Distressed Asset Stabilization Program, a program to offer pools of defaulted loans to investors.[193] The stated intention of the program is to allow "pools of mortgages headed for foreclosure to be sold to qualified bidders and charges them with helping to bring the loan out of default."[194] In order to be part of the program the loan must be at least six months delinquent, the servicer must have exhausted loss mitigation options and the foreclosure must have been initiated.[195] It is too early to know if the sale of these notes will truly offer new hope for struggling homeowners and neighborhoods. The initial pools of loans were sold in September 2012.[196] They were divided into one national pool and one neighborhood stabilization pool of loans originating from Chicago, Illinois; Newark, New Jersey; Phoenix, Arizona; and Tampa, Florida—all areas previously identified as having high numbers of abandoned foreclosures and vacant homes.[197] Consumer advocates are dubious of the Distressed Asset Stabilization Program's ability to provide relief to struggling homeowners and neighborhoods.[198]

The National Consumer Law Center has issued several

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[190] Default Judgment Entry and Decree of Foreclosure, *Estrada*, No. 71-D05-1212-MF-00787 (entered May 10, 2013).

[191] Estrada Motion to Set Aside Judgment, *supra* note 188 at ¶ 1.

[192] Judge Manier Interview, *supra* note 186.

[193] HUD No. 12-116, *supra* note 71.

[194] U.S. DEP'T OF HOUS. & URBAN DEV. HUD NO. 12-187, HUD ANNOUNCES PRELIMINARY RESULTS OF NOTE SALES UNDER EXPANDED DISTRESSED ASSET STABILIZATION PROGRAM (Dec. 3, 2012) [hereinafter HUD No. 12-187], http://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2012/HUDNo.12-187.

[195] *Id.*

[196] Nathaniel Cushman, *HUD Announces September 2012 Loan Sale*, NIXON PEABODY AFFORDABLE HOUS. RES. CTR. (July 25, 2012, 11:02 AM), http://web20.nixonpeabody.com/ahrc/Lists/Posts/Post.aspx?List=023e142d%2Dcf9f%2D44c8%2D8bf3%2D5aaaeeb635b8&ID=45.

[197] *Id*.

[198] FHA REFORM, *supra* note 71; HOME RETENTION GOALS, *supra* note 71.

responses and recommendations regarding this program.[199] One of the concerns is that the program will reward those servicers who delay "loss mitigation reviews beyond the time frames allowed" by allowing them to sell the loan without really having done loss mitigation.[200] The program may also be encouraging lenders to "un-foreclose" some long abandoned properties in an effort to remove these properties from their books instead of focusing on saving the homes in default that have not yet been foreclosed. The short amount of time between some of these judgments and motions to vacate suggests that better communication between the servicers and their counsel could prevent the delay in resolving the foreclosure caused by foreclosing and then vacating judgments. It may also prevent some people from abandoning their home because they thought the foreclosure judgment was the end of their opportunity to save the home.[201] The theory behind the program is that the investor will be able to work with the homeowner to remain in the home, but in reality by the time the loans reach the program most of these homeowners will be long gone. One concern is that this kind of program may result in once stable neighborhoods becoming transient, rental neighborhoods.[202] At the same time, rental homes are better than abandoned homes.

The cases coming before the St. Joseph Superior Court raise other, serious concerns. It is not credible that the reason for setting aside a judgment for a deceased borrower is to increase the opportunity for the borrower to engage in loss mitigation. Are these programs really designed to increase the opportunity for loss mitigation, as advertised,[203] or are they instead encouraging, or even mandating, the setting aside of previously entered judgments so that HUD, Fannie Mae and Freddie Mac can unload assets? I submitted an inquiry to HUD asking whether or not loan servicers were being instructed to set aside judgments in

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[199] *Id.*

[200] HOME RETENTION GOALS, *supra* note 71.

[201] GAO-11-93, *supra* note 10, at 17-18 (finding that homeowners are much more likely to abandon a property if the loan is charged off after foreclosure than if it is charged off before foreclosure is initiated).

[202] Julie Schmit, *Home rentals—the new American Dream?,* USA TODAY (last updated June 6, 2012, 10:02 AM), http://usatoday30.usatoday.com/money/economy/housing/story/2012-06-05/are-home-rentals-the-new-american-dream/55402648/1.

[203] *See* HUD No. 12-187, *supra* note 194.

order for the underlying loans to be included in this program.[204] I was told that their attorney would get back to me.[205] No one has.[206]

IV. DEFICENCY JUDGMENTS AND DEBT BUYERS

It should now be clear that a motivating factor—if not the motivating factor—in the abandoned and zombie foreclosures is lenders ability to sell the notes into the secondary market. The secondary market is a market of investors and debt buyers. The debts differ depending on whether they are secured, as in the selling of a note to an investor, or unsecured, as in the selling of a note, without the mortgage, or the deficiency judgment. The relationship between the abandoned foreclosure problem and the debt collection problem was well articulated by St. Joseph Superior Court Judge Jenny Manier:

> Well, if I'm a defendant against whom an in rem judgment has been entered, I've lost the property and I have no deficiency judgment. Judgment's vacated, which what, gives rise or resuscitates the debt and the bank says, you know, we don't want to be stuck with this piece of property and this debt that we'll be collecting for the next 20 years, let's sell the underlying debt to someone else for dimes on the dollar, pocket the money and count on it as loss mitigation. And then the purchases is now going after this person, this defendant who thought they had walked away by losing just their home but without any deficiency. And all of a sudden someone is suing them for the same judgment that they thought had been resolved.[207]

A. The Deficiency Judgment

As mentioned previously, it is clear that some foreclosure

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[204] E-mail from author to John Hall, Indianapolis Field Officer, HUD, (Aug. 14, 2013) (on file with author).

[205] Email from John Hall, *supra* note 204, to author. (Aug. 14, 2013) (on file with author).

[206] There has been no response as of September 10, 2013.

[207] Hearing Transcript, *supra* note 88, at 7 (explaining to lender's counsel why she is concerned with setting aside an in rem judgment of foreclosure).

judgments are being vacated solely to facilitate the sale of the loan.[208] Others are vacated because the homeowner obtained a loan modification or reinstated the loan. It is also clear that some homeowners, in the end, cannot climb out from under the debt and the property is foreclosed, leaving them with a deficiency judgment. Below is one extreme example of this, taken from Howard County, Indiana. These are all foreclosures on the same property, against the same property owner, filed from 2003 through 2008:

PLAINTIFF	DATE FORECLOSURE FILED	DATE OF JUDGMENT	AMOUNT OF JUDGMENT	VACATED AND NOTE REINSTATED
MERS[209]	10/ 3/2003	12/ 18/ 2003	$141,544.39	2/9/2004
MERS[210]	1/3/2005	3/6/2005	$146,944.51	8/25/2005
Irwin Mortgage[211]	8/17/2006	10/17/2006	$146,957.37	10/24/2006
ABN AMRO[212]	5/1/2007	7/31/2007	$140, 062.83	11/20/2007
Citimortgage[213]	3/11/2008	4/16/2008	$140,462.45	11/25/2008
Citimortgage[214]	11/21/2008	1/20/2009	$140,075.96	8/19/2009 judgment assigned

CHART B: THE HISTORY OF ONE LOAN IN INDIANA

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[208] It is also possible that some of these are simply servicer changes. It is virtually impossible to determine who owns a loan when looking at the pleadings.

[209] Civil Case Detail, Mortg. Elec. Registration Sys., Inc. v. Newburn, No. 34D02-0310-MF-00950 (Howard Cnty., Ind. Super. Ct.) (Doxpop).

[210] Civil Case Detail, Mortg. Elec. Registration Sys., Inc. v. Newburn, No. 34D01-0501-MF-00062 (Howard Cnty., Ind. Super. Ct.) (Doxpop).

[211] Civil Case Detail, Irwin Mortg. Corp. v. Newburn, et. al., No. 34D02-0608-MF-00776 (Howard Cnty., Ind. Super. Ct.) (Doxpop).

[212] Civil Case Detail, ABN AMRO Mortg. Grp., Inc. v. Newburn, No. 34 D040705-MF-00476 (Howard Cnty., Ind. Super. Ct.) (Doxpop).

[213] Civil Case Detail, Citimortgage, Inc. v. Newburn, No. 34C01-0803-MF-00240 (Howard Cnty., Ind. Cir. Ct.) (Doxpop).

[214] Civil Case Detail, Citimortgage, Inc. v. Newburn, No. 34C01-0811-MF-01164 (Howard Cnty., Ind. Cir. Ct.) (Doxpop).

The property in question is located in Kokomo, Indiana. On October 3, 2003 Mortgage Electronic Registration Systems (MERS) filed a foreclosure action, obtaining a default judgment two months later.[215] On February 9, 2004 that judgment was vacated and, according to the court, the "note and mortgage canceled by merger in the judgment are hereby reinstated."[216] Eleven months later, MERS filed another foreclosure.[217] Again, a default judgment was entered. The amount of the judgment has now increased from $141, 544.39 to $146, 944.51, a difference of $5,400.12.[218] It appears from the figures that few, if any, payments were made in the intervening year. Five months after entry of the default judgment, the court again vacated the judgment and reinstated the loan.[219]

The next foreclosure on this property was filed by Irwin Mortgage in August of 2006, a year after the previous judgment was vacated.[220] It too obtained a default judgment.[221] Interestingly, this judgment was only slightly larger than the previous judgment, suggesting some payments had been made. One month later, Irwin set the judgment aside and reinstated the note.[222] The speed at which this judgment was set aside, coupled with the significant decrease in the next judgment amount (see Chart B, above), suggests the homeowners may have reinstated the loan by bringing it current at this point. Apparently, though, it did not last.

On May 1, 2007, ABN AMRO filed to foreclose on the same mortgage, now for the fourth time in as many years.[223] Again, it obtained a default foreclosure judgment and quickly moved to vacate the judgment and re-instate the note.[224]

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[215] Civil Case Detail at 2, Mortg. Elec. Registration Sys., Inc. v. Newburn, No. 34D02-0310-MF-00950 (Minute Entry, Dec. 18, 2003).

[216] *Id.* at 3, (Minute Entry, Feb. 9, 2004).

[217] *Id.* at 1, (Minute Entry, Jan. 21, 2004).

[218] *Id.* at 2 (Minute Entry, March 6, 2005).

[219] *Id.* at 3 (Minute Entry, Aug. 25, 2005).

[220] Civil Case Detail at 2, Irwin Mortg. Corp. v. Newburn, No. 34D02-0608-MF-00776 (Minute Entry, Aug. 17, 2006).

[221] *Id.* at 2-3 (Minute Entry, Oct. 24, 2006).

[222] *Id.* at 3 (Minute Entry, Nov. 2, 2006).

[223] Civil Case Detail at 1-2, ABN AMRO Mortg. Grp., Inc. v. Newburn, No. 34D04-0705-MF-00476 (Minute Entry, May 1, 2007).

[224] Id. at 2 (minute entries of default judgment on July 31, 2007 and vacating

Citimortgage entered the picture on March 11, 2008 when it filed the fifth attempt to foreclose on this property.[225] It obtained a judgment and also vacated it, reinstating the note and mortgage on November 25, 2008.[226]

The reason for vacating this judgment is clear: four days earlier, on November 21, 2008, Citimortgage had filed another foreclosure action on this same note and mortgage.[227] Indiana, like most states, does not permit a plaintiff to bring a second action to foreclose when it is currently "prosecuting any other action for the same debt."[228] It is odd that Citimortgage would chose to set aside a judgment it had already obtained in the first filing, as opposed to dismissing the second, extraneous filing, but it did. The last and final foreclosure judgment was entered on January 20, 2009 against the owners for $140,075.96 plus interest and costs.[229]

The county land records show that on November 10 the property was transferred from the homeowners to Fannie Mae, and then to a third party purchaser.[230] The price paid by the purchaser was $22,000.[231] The homeowners now owe a deficiency judgment of over $120,000.[232] That judgment was promptly assigned to a debt buyer, Dyke O'Neal.[233] Dyke O'Neal claims to be "a leading nationwide purchaser, collector and servicer of real

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judgment on Nov. 20, 2007).

[225] Civil Case Detail at 2, Citimortgage, Inc. v. Newburn, No. 34C01-0803-MF-00240 (Minute Entry, Mar. 11, 2008).

[226] *Id.* at 2-3 (minute entries: entering foreclosure judgment on Apr. 16, 2008; vacating judgment and reinstating note on Nov. 25, 2008).

[227] Civil Case Detail at 3, Citimortgage, Inc. v. Newburn, No. 34C01-0811-MF-01164 (Minute Entry, Nov. 21, 2008).

[228] IND. CODE § 32-30-10-10 (2013).

[229] "Court now grants the Application and now finds in favor of the Plaintiff, Citimortgage, Inc. and against the Defendants, in the sum of $140,075.96, plus interest and costs, all per DEFAULT JUDGMENT ENTERED. Furthermore, Court now finds the property commonly known as 1105 Witherspoon, Kokomo, IN 46901 herein foreclosed and ordered sold by the Sheriff of Howard County all per Decree of Foreclosure." Civil Case Detail, Citimortgage v. Newburn, No. 34C01-0811-MF-01164 (Minute Entry, Jan. 20, 2009).

[230] *Id.*

[231] *Id.*

[232] *Id.*

[233] Civil Case Detail, Citimortgage v. Newburn, No. 34C01-0811-MF-01164 (Minute Entry, Aug. 19, 2009).

estate deficiencies."[234] They set to work immediately to collect the deficiency in this matter.[235] Unsurprisingly, the homeowner filed bankruptcy, notifying the court on April 25, 2012.[236]

A deficiency judgment is the amount of money a homeowner may still owe the lender if, after foreclosure, the home is not worth as much as the underlying mortgage debt.[237] Deficiency judgments have always been an issue in hard economic times. In this crisis, policy makers focused on the loan modification as a solution.[238] In the depression, the relief offered was restrictions on deficiency judgments.[239] Challenges to this relief were decided in the borrowers' favor when, in *Gelfert v. National City Bank of New York*,[240] the United States Supreme Court held that a state may restrict the lender's recourse in a mortgage foreclosure. Several states have restricted or eliminated

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[234] DYKE O'NEAL, INC., http://www.dyckoneal.com/ (last visited September 9, 2013). It should be noted that the state of Georgia has a Cease and Desist Order against this company for operating as a mortgage lender and broker without a license. DEPARTMENT'S ORDER TO CEASE AND DESIST AGAINST DYCK-O'NEAL, INC. BECOMES FINAL, GA. DEP'T OF BANKING AND FIN. (May 22, 2009) [hereinafter Georgia Cease and Desist Order], http://dbf.georgia.gov/press-releases/2009-06-30/departments-order-cease-desist-against-dyck-oneal-inc-becomes-final/. The state of Massachusetts has a consent order relating to violations of the Massachusetts debt collection laws. DYKE O'NEAL, INC. – CONSENT ORDER, MASS. OFFICE OF CONSUMER AFFAIRS AND BUS. REGULATION (May 5, 2011), http://www.mass.gov/ocabr/business/banking-services/banking-legal-resources/enforcement-actions/2011-dob-enforcement-actions/dyck-oneal-inc-consent-order.html.

[235] It should also be noted that Dyke O'Neal does not, according to the Indiana Secretary of State, have the required license to act as a debt collector in Indiana.

[236] Civil Case Detail, Citimortgage v. Newburn, No. 34C01-0811-MF-01164 (Minute Entry, Apr. 25, 2012).

[237] Deficiency judgments are allowed in some form in the majority of the states. Twelve, including some of those hit hardest by this crisis such as California and Arizona, have passed statutes barring deficiency judgments in most circumstances. Twenty other states limit the impact of the deficiency by requiring the lender to calculate the deficiency based on market value and not the price obtained in sheriff sale. Unfortunately, Indiana falls in neither camp and allows deficiency judgments in every situation. Foreclosure Defense, *supra* note 31, app. E, at 547-49.

[238] White, s*upra* note 52, at 514.

[239] D. J. Farage, *Mortgage Deficiency Judgment Acts and Their Constitutionality*, 41 DICK. L. REV. 67 (1937).

[240] *Gelfert v. Nat'l City Bank of New York*, 313 U.S. 221, 235, 61 S. Ct. 898, 85 L. Ed. 1299 (1941).

the right to a deficiency judgment.[241] Most states allow for at least some collection of deficiency judgments.[242] Indiana has no real restrictions.

The Newburn cases illustrated above are extreme, or are they? Numerous loans have been coming in and out of foreclosure since the start of this crisis.[243] This case shows us just how large a deficiency a homeowner can accumulate in a depressed housing market. It also raises serious questions about the servicing of this loan. A significant amount of legal time and energy went into the filing of six successive foreclosure actions, two even pending at the same time. The case is symptomatic of a chaotic industry. The homeowner incurred attorney's fees in each of the filings.

The lack of meaningful communication between the servicer and its foreclosure attorney is another problem evident in this and many foreclosure cases. The foreclosing attorney is often communicating to its client through the same toll free numbers as the consumers.[244] An example of this can be seen in the exchange between the court and JP Morgan Chase's foreclosure counsel in the hearing to set aside a foreclosure judgment previously discussed.[245] The only message the attorney received from his client was "loss mitigation."[246] He was not told that, a month earlier, this home had been sold in a short sale with the full knowledge and approval of his client.[247] While it is desirable to encourage loss mitigation, real loss mitigation requires real communication between all the stakeholders in the process.

It does not appear from the court file that much loss mitigation occurred for this homeowner in Kokomo. However, because the homeowner could well have been working with the lender and the lender did not communicate this information to its counsel, it is equally possible that loss mitigation was occurring

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[241] Foreclosure Defense, *supra* note 31, app. E, at 547-53. Twelve states bar deficiency judgments. *Id.* at 548.

[242] Of the thirty-eight states that allow some form of deficiency, twenty have enacted at least some restrictions. *Id.*

[243] *See, generally* White, *supra* note 52 (Allen M. White on the old mod model).

[244] Since 2011, I have facilitated hundreds of settlement conferences between the homeowner and their counsel. This is a common complaint of lender's counsel.

[245] *See supra* text accompanying notes 135-53.

[246] Hearing Transcript, *supra* note 88, at 3.

[247] *See supra* note 149 and accompanying text.

throughout the process.[248] At the same time, there were not many successful loss mitigation options available when the first four cases were filed.[249] The homeowner failed to appear in all of the six cases filed and the foreclosure fees mounted. Yet, each time a judgment was entered it was set aside and the note sold. A home in foreclosure for over five years must increase the fees and the ultimate balance due. In the end, this home sold for less than 15% of the judgment. The delay in foreclosing is at least partially responsible for this increase.

The growing balance is one of the problems with the collection of deficiency judgments. Once entered, the judgment continues to accrue interest in Indiana at the judgment interest rate, currently 8%.[250] Another is the complete lack of information provided to the homeowner. There is a record of the court judgment in the court file and, presumably, a copy of that order is sent to the borrower. However, there is no record of the amount, if any, of the deficiency. Only some courts make any note of it at all. Some states require confirmation of the judgment.[251] The third, and most disturbing, is that by allowing lenders to set aside agreed "in rem" judgments courts have resurrected the possibility of a deficiency judgment that the homeowner believed he had avoided by agreeing to judgment in the first place.[252] Once obtained, the deficiency debt enters the murky world of debt collection, already awash in bad information and controversial practices.[253]

B. The Debt Buyer

It is not clear how many debt buyers are in the market for mortgage debt.[254] The federal trade commission recently

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[248] *See supra* Part II.B. for a discussion of dual tracking.

[249] White, *supra* note 52 (documenting the lack of success of loss mitigation efforts in 2007 and 2008).

[250] IND. CODE § 24-4.6-1-101(1)(2013).

[251] Foreclosure Defense, *supra* note 31, app. E, at 550-52.

[252] Hearing Transcript, *supra* note 88, at 6.

[253] *See generally* FEDERAL TRADE COMMISSION, REPAIRING A BROKEN SYSTEM: PROTECTING CONSUMERS IN DEBT COLLECTION LITIGATION AND ARBITRATION (July 2010), *available at* www.ftc.gov/os/2010/07/debtcollectionreport.pdf.

[254] At the moment, at least, the market seems to be stronger for the nonperforming loans, hence the moves to set aside judgments. *See* Rudolf, *supra* note 70; Said, *supra* note 70; Yu & Kelly, *supra* note 133; Morrissey,

concluded an investigation of the debt buying industry that included specific data on the top nine debt buying firms.[255] From 2005 through 2011, mortgage debt accounted for approximately one percent of the debt acquired.[256] The average price paid was fifty cents on the dollar. The report goes on, however, to clarify that these numbers are skewed by the fact that some portfolios were tied to performing loans. In fact, "a significant number of mortgage portfolios" were acquired for less than one cent per dollar.[257] The mean price was ten cents per dollar.[258]

Dyke O'Neal purchased the debt in the case illustrated in Chart B.[259] This company claims it has been in the business of buying mortgage deficiencies since 1988.[260] According to their webpage, Dyke O'Neal is "the leading nationwide purchaser, collector and servicer of real estate deficiencies."[261] The size and opportunities these markets now bring for both legitimate investors and bottom-feeding debt collectors has changed due to this crisis. As debt collectors, who traditionally shied away from mortgage deficiency collection, enter the market, they are likely to bring the problems associated with the collection of credit cards into the world of mortgage deficiencies.[262]The problems

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supra note 133.

[255] *See* FEDERAL TRADE COMMISSION, THE STRUCTURE AND PRACTICES OF THE DEBT BUYING INDUSTRY (January 2013) [hereinafter Debt Buying], *available at* www.ftc.gov/os/2013/01/debtbuyingreport.pdf. The nine firms that provided specific data to the study were Sherman Financial, Arrow Financial Services, LLC., Encore Capital, Portfolio Recovery Associates, LLC, Unifund Corp., eCast, B-Line LLC., Asta Funding, NCO Portfolio Mgmt. *Id.* at 7. Because the data is limited to these firms, it is not a complete picture of the debt buying marketplace.

[256] *Id.* at T-4.

[257] *Id. at* T-5.

[258] *Id.*

[259] *See supra* notes 233-36 and accompanying text.

[260] DYKE-O'NEAL, INC., http://www.dyckoneal.com (last visited September 9, 2013).

[261] *Id. But see supra* note 234 (describing Cease and Desist Order issued by the Georgia Department of Banking and Finance, and Consent Order issued by Massachusetts Office of Consumer Affairs and Business Regulation).

[262] Recent crackdowns on the selling and collecting of credit card debt could easily cause debt buyers to search for other revenue streams. *See generally,* Maria Aspan & Jeff Horwitz, *Chase Halts Card Debt Sales Ahead of* Crackdown, AMERICAN BANKER (July 1, 2013, 3:29 PM), http://www.americanbanker.com/issues/178_126/chase-halts-card-debt-sales-ahead-of-crackdown-1060326-1.html (explaining that Chase has halted selling its credit card debt because of investigations into robo-signing). The

associated with the collection of mortgage debt are already surfacing in relation to the collection of second mortgage loan debt.[263]

The debt collection industry is structured to allow debts to be bought and sold with little underlying documentation and supporting paperwork.[264] When you combine this with the recorded paperwork disaster that has become common in the world of mortgage foreclosure,[265] the results can be nothing but bad.

V. CONCLUSION AND RECOMMENDATIONS

Abandoned foreclosures and zombie titles pose concerns for consumers and their communities. Policy makers need to act to mitigate the impact of these problems before they become a crisis themselves, the "foreclosure echo." A review of foreclosure processes in Indiana and abandoned homes across the nation leads me to recommend the following:

A. The Foreclosure Process

The current judicial foreclosure process may have some issues, but the answer is not to speed up the process, as industry advocates claim. It is, instead, to determine whether the foreclosure can be avoided before you initiate the judicial foreclosure process. If loss mitigation were truly incentivized over foreclosure, the number of homes moving into foreclosure and then stalling could be reduced. When a home is truly abandoned,

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investigation will likely spread, as they did in the foreclosure crisis, prompting other credit card lenders to also stop selling their debt, at least temporarily.

[263] Carolyn Said, *Homes Lost, but Some 2nd-Mortgage Debts Remain*, S.F. CHRON. (April 19, 2010, 4:00 AM), *http://www.sfgate.com/realestate/article/Homes-lost-but-some-2nd-mortgage-debts-remain-3266964.php* (explaining the rise in mortgage debt collection on second mortgages); Jim Wasserman, *Debt Collectors can Come Calling Years After a Mortgage Default*, WASH. POST, March 27, 2010, at E06.

[264] Debt Buying, *supra* note 255, at iii.

[265] Commission Report, *supra* note 2, at 407-08 (discussing how the flawed paperwork exacerbated foreclosure issues); Allen et al., *supra* note 16, at 29 (finding "greater incidence of foreclosure case dismissals (resulting from legal and operational problems) is associated with a greater likelihood that a loan remains in limbo"); Streitfeld, *supra* note 63.

efforts should be made to quickly foreclosure in a way that allows the asset to be purchased and re-occupied before it falls into disrepair. The focus should be on the "home" asset and not the "loan" asset.

Lenders should not be rewarded for shoddy loss mitigation by allowing them to vacate the judgment and sell the loan.

Decisions about the economic viability of the foreclosure should be made before the foreclosure action is filed to decrease the number of homeowners who prematurely leave their homes.

Servicers must communicate accurate and timely information to their counsel to avoid wasted judicial time and the filing of frivolous motions.

Homeowners should be notified when a lender has decided to charge-off a loan, cancel a sale or otherwise abandon a foreclosure.

Dual tracking is alive and well, despite efforts to the contrary. It needs to finally and completely end.

The loss mitigation system is still too slow, too long and too confusing. The industry can, and should, agree to one short set of paperwork that can be completed and processed in a manner that does not drag on for years.

Lenders that have no interest in the asset should waive their mortgages to allow homeowners and municipalities ways to transfer the property to an occupying buyer.

B. The Court Process

The court process begins and ends with knowledgeable judges. Judges need to understand the implications of vacating judgments on the homeowner and the community. Courts are best able to control the time a foreclosure remains in process. Unfortunately, courts are also overburdened and understaffed. Policymakers need to address those issues as well.

Judges need to be educated as to the many implications of setting aside a foreclosure judgment.

Requiring creditors to comply with Trial Rule 60 would end most of the abuses.

Courts should better control their dockets by dismissing foreclosure actions that have been open with no activity for long periods of time.

All deficiency amounts should be accurately recorded in the record and readily accessible to the consumer.

C. Policy-Makers

This problem will grow as the economy improves. Creditors and debt collectors, who previously saw no hope of recovery, will soon have wages to garnish. Simple steps can be taken now to prevent this from becoming a second foreclosure debt crisis.

The re-securitization of zombie mortgage debt needs to be closely monitored by regulators.

The debt buying industry must be required to have complete and accurate information of the deficiency judgment and the documents to prove it, before collection proceedings can be initiated.

Lenders should be required to inform homeowners when they cancel a sheriff's sale, not just when they initiate one.

These suggestions are all simple, easily implemented steps. I am not the first to offer many of them. We are in a position to mitigate the possible fallout of the foreclosure crisis. Policymakers can choose to get ahead of the problem or wait to clean up another mess. I encourage them to choose the former. As the evidence shows, it is not the homeowners who are walking away from their mortgage; it is the mortgage industry that has walked away from the homeowners. It is long since passed the time to turn them around.