

**SUBCOMMITTEE ON HOUSING AND COMMUNITY  
OPPORTUNITY**

**OF THE COMMITTEE ON FINANCIAL SERVICES**

**U.S. HOUSE OF REPRESENTATIVES**

**“LEGISLATIVE SOLUTIONS FOR PREVENTING LOAN MODIFICATION  
AND FORECLOSURE RESCUE FRAUD”**

**MAY 6, 2009**

**2128 RAYBURN HOUSE OFFICE BUILDING**

**10:00 a.m. to 2:00 p.m.**

**Testimony of**

**Scott J. Drexel  
Chief Trial Counsel  
The State Bar of California**

Madam Chairwoman and Honorable Members of the Subcommittee on Housing and Community Opportunity:

Thank you for the opportunity to appear before your Subcommittee today and to address the California State Bar's perspective on loan modification and foreclosure rescue fraud.

My name is Scott Drexel. I am the Chief Trial Counsel of the State Bar of California. California has a total of more than 225,000 lawyers, more than 165,000 of whom are active members and entitled to practice law in our State. Approximately one of every seven attorneys in the United States is a California attorney.

My Office is responsible for the investigation of complaints against California attorneys and for the disciplinary prosecution of those attorneys who have violated our Rules of Professional Conduct or our State Bar Act.

Typically, my Office receives about 75,000 telephone calls to our toll-free complaint line and more than 15,000 written complaints about the conduct of lawyers.

Since approximately November 2008, telephone calls to our toll-free telephone lines have increased by more than 15 percent and we have received an average of nearly 900 telephone calls per month on the subject of loan modification and foreclosure rescue fraud, an annual rate of more than 10,000 telephone calls on this subject alone.

Clearly, this is a problem of extremely significant -- if not crisis -- proportions in California. The problem is so serious that, in February 2009, the California State Bar's Committee on Professional Responsibility and Conduct issued an "Ethics Alert," warning California attorneys and the public of the dangers of foreclosure rescue and loan modification fraud and to remind California attorneys of ethics rules that may impact their involvement in these matters.

In response to the large number of written complaints received by my Office on this subject, we have created a staff task force to focus solely on complaints of foreclosure rescue and loan modification fraud. We are working extensively in cooperation with other agencies to address the issues, especially the California Department of Real Estate, which regulates mortgage foreclosure consultants in California.

We have been proactive in our response to the suspected involvement of California attorneys in foreclosure rescue and loan modification fraud.

Pursuant to our statutory authorization, in March 2009, we successfully petitioned a California superior court to assume jurisdiction over the practice of a California attorney who was engaged in suspected loan modification fraud. Pursuant to court order and with the assistance of local law enforcement, we seized more than 2,300 of the attorney's client files, downloaded records from his computers, froze his client trust and office bank accounts and redirected his telephones and mail delivery to the State Bar's offices. We are in the process of returning files and advanced fees to the attorney's clients and assisting them in redirecting them to legitimate practitioners and others for help.

We have attacked the accuracy and propriety of attorney print, radio, television and Internet advertisements for loan modification services. Under California's Rules of Professional Conduct, attorneys are prohibited from making false, misleading or deceptive statements in advertisements and can neither make guarantees of success or advertise past successes without appropriate disclaimers and without having evidence to demonstrate the accuracy of those claims. In those cases where we suspect violations of our advertising rules, my Office has demanded the production of copies of all of the attorney's or law firm's advertisements, along with documentary evidence substantiating the accuracy of their claims. Our goal is to force the removal of all false or misleading advertisements from the print, radio and television media, thereby making it more difficult for unethical practitioners to prey upon members of the consuming public.

We have initiated more than 175 active investigations of attorneys suspected of engaging in foreclosure rescue and loan modification fraud. We are especially targeting those practitioners against whom we have received multiple complaints or who appear to be particularly egregious in their victimization of consumers.

On Thursday, May 7, 2009, we will be meeting with representatives of the United States Attorney's Office in Los Angeles, the California Attorney General's Office, the Department of Housing and Urban Development, the Federal Trade Commission, the California Department of Real Estate, the Los Angeles District Attorney's Consumer Fraud Unit and others to share information, coordinate investigations and develop a comprehensive strategy for attacking these fraudulent practices.

In light of our experience to date, I will attempt to respond to some of the specific issues and questions posed by your Subcommittee.

- **What are the most common types of foreclosure rescue fraud?**

To date, the most common type of foreclosure rescue fraud that we have encountered, both by attorneys and by non-attorneys, have been false promises to consumers through advertisements that they can successfully negotiate with lenders to modify their mortgages, adjust their mortgage interest rates and reduce their monthly mortgage payments. The most crucial aspect of their fraud is to obtain an advance payment from the consumer of amounts ranging from \$2,500 to more than \$10,000. The foreclosure consultant, attorney or organization then fails to take any effective action on the consumer's behalf.

- **How will H.R. 1231 be effective in preventing foreclosure rescue fraud? In what ways can the legislation be improved in this regard?**

H.R. 1231 will provide significant assistance in preventing foreclosure rescue fraud by (a) prohibiting foreclosure consultants from demanding or receiving any advance payments from a homeowner until the consultant has fully performed each of the promised or agreed upon services and by prohibiting them

from either acquiring an interest in the homeowner's property or obtaining a power of attorney from the homeowner; and (b) requiring loan servicers to notify homeowners of the dangers of fraudulent activities associated with foreclosure and to direct them to the Department of Housing and Urban Development for assistance in avoiding foreclosure.

H.R. 1231 currently excludes attorneys, licensed real estate brokers and salespersons and others from the definition of "foreclosure consultant." While real estate brokers and salespersons in California are not permitted to request or receive advanced fees after a Notice of Default has been recorded and may only receive advanced fees prior to that date with the specific approval of the California Department of Real Estate, attorneys in California are permitted to request and receive advanced fees. Moreover, unlike many other states, California attorneys are not required to deposit advanced fees in their client trust accounts and to only remove those fees from trust as services are performed. Rather, California attorneys may treat the advanced fees as their own funds, with the caveat that, if the client terminates the attorney prior to the time that the attorney has earned all of the advanced fees or a dispute develops over whether the attorney has earned the entire amount of the advanced fees, the attorney has an obligation to deposit and maintain the disputed funds in his or her client trust account until the dispute is resolved.

The ability of attorneys to request and receive advanced fees has encouraged many non-attorney foreclosure consultants to seek either the knowing or largely unwitting involvement of attorneys in their mortgage foreclosure scams. The consumer is falsely promised that the foreclosure rescue or loan modification services are being provided under the guidance of an attorney and advanced fees are requested and received under the guise of a legitimate attorney-client relationship. The attorney then receives a portion of the advanced fees, with the remainder being retained by the foreclosure consultant.

H.R. 1231 can be improved by finding an effective means to prohibit such conduct by attorneys, especially when working in conjunction with non-attorney foreclosure consultants.

- **How effective has California state legislation been in preventing foreclosure rescue fraud? How should federal legislation complement or build upon state efforts?**

California has regulated mortgage foreclosure consultants by legislation since 1979. (Calif. Civ. Code, §§ 2945, *et seq.*) Among other things, the Mortgage Foreclosure Consultants Act has prohibited foreclosure consultants from receiving advanced fees for services after a Notice of Default has been recorded, requires contracts between foreclosure consultants and homeowners to be in writing and prohibits the foreclosure consultant from obtaining any direct or indirect interest in the homeowner's property.

However, what the California legislation has lacked is an effective enforcement mechanism. The California Department of Real Estate ("DRE") oversees the activities of mortgage foreclosure consultants. While the DRE has the authority to issue "desist and refrain" letters to foreclosure consultants who violate the provisions of the Act, they must rely upon the local district attorneys for any criminal prosecution.

There is legislation currently pending in California that would assist in combating foreclosure rescue and loan modification fraud. If enacted, Senate Bill 94 would broaden the prohibition against receiving advanced fees to all individuals engaged in loan modification services, including attorneys. It would also require individuals engaged in loan modification services to provide specific warnings to homeowners and to notify them that there are free counseling and borrower assistance services available from a list of nonprofit housing counseling agencies approved by the Department of Housing and Urban Development.

While both the current Mortgage Foreclosure Consultants Act and the proposed provisions of S.B. 94 provide important protections for the homeowner from fraudulent activities of foreclosure consultants, attorneys and others, the key to resolving this crisis is an effective enforcement mechanism, either through criminal prosecutions or through injunctive relief.

- **In what way does state legislation regulate loan modification companies that charge fees to homeowners who may not have missed any payments? How should Federal legislation address these kinds of companies?**

In California, mortgage foreclosure consultants are permitted to receive advanced fees for services if no Notice of Default has been recorded. However, there must be a written agreement between the foreclosure consultant and the homeowner that specifies the services to be provided and, most critically, the agreement for advanced fees must be reviewed and approved in advance by the California Department of Real Estate. Moreover, foreclosure consultants who are authorized by DRE to receive advanced fees from the homeowner must deposit and maintain those fees in a trust account and may only remove the fees as they are earned.

Any federal legislation enacted in this area should be consistent with these provisions of California law.

- **How are some attorneys and real estate brokers complicit in loan modification and foreclosure rescue fraud?**

Attorneys have been complicit in loan modification and foreclosure rescue fraud in several respects. The key component of their involvement in fraudulent activities is their ability to demand and receive advanced fees for services.

Regrettably, a certain number of attorneys are willing to engage in these fraudulent activities on their own.<sup>1</sup> In many cases, however, attorneys are approached by non-attorney foreclosure consultants who seek to work in concert with them. In exchange for the use of the attorney's name and his or her ability to charge and receive advanced fees, the foreclosure consultant typically offers to perform most or all of the loan modification services and promises to either

---

<sup>1</sup> In one particularly egregious case, the attorney and the foreclosure consultants with whom he is working have talked homeowners into providing them with bank account information before the homeowner has even signed an agreement retaining the attorney for loan modification services. The attorney then electronically withdraws funds from the homeowner's bank account without any prior notice or authorization from the homeowner and before the homeowner has even decided to retain the attorney.

pay the attorney a specified amount for each loan modification or to provide an agreed-upon percentage of the fees received from the homeowner.

The foreclosure consultants often prey upon new attorneys who are unaware of their ethical responsibilities and who, in the current economy, are having problems in attracting sufficient legal business. These consultants also appear to prey upon older attorneys who cannot afford to retire but who no longer have the energy or ability to maintain a large law practice by offering them a steady monthly income to supplement what the attorney can earn through his or her legitimate law practice.

Besides the fraudulent aspect of the activities themselves, these arrangements violate numerous provisions of California's Rules of Professional Conduct. For instance, rule 1-310 of the Rules of Professional Conduct prohibits a member of the State Bar from forming a partnership with a person who is not a lawyer if any of the activities of the partnership consist of the practice of law.

Similarly, rule 1-320 prohibits a member or a law firm from directly or indirectly sharing legal fees with a person who is not a lawyer, with exceptions that are not applicable to the alleged services to be provided by foreclosure consultants.

Additionally, members of the State Bar have a duty to obey and support the constitution and laws of the United States and of the State of California. (Calif. Bus. & Prof. Code, § 6068, subd. (a).) Acts of the attorney that aids or abets the violation of the Mortgage Foreclosure Consultants Act or other provision of law constitutes a violation of section 6068, subdivision (a).

- **How are some attorneys and real estate brokers useful in preventing loan modification and foreclosure rescue fraud?**

The vast majority of attorneys in California are ethical practitioners who are dedicated to providing quality legal services to their clients. Attorneys who are actively engaged in providing legitimate loan modification services to their clients have been willing to report to both the State Bar and the Department of Real Estate suspected fraudulent activities by attorneys and non-attorneys. They



have also reported to the State Bar that they have been repeatedly approached by non-attorney foreclosure and loan modification consultants interested in using their law licenses to receive advanced fees and offering to share fees received from consumers.

Many attorneys have also provided free legal advice and services to homeowners whose homes are in foreclosure or who are seeking to modify existing mortgage loan agreements.

- **What types of fees are typically charged by foreclosure consultants and loan modification companies? In what ways are these fees excessive?**

In the cases that the California State Bar has been investigating, we have typically encountered advanced fees for loan modification services ranging from approximately \$2,500 to more than \$10,000, with the average fee in the range of about \$3,000 to \$4,000.

In most of the cases that the State Bar is investigating, the attorney and/or the foreclosure consultant perform few, if any, services in exchange for these advanced fees. In essence, these monies have been obtained from homeowners under false pretenses. At most, in exchange for these advanced fee payments, the attorneys or foreclosure consultants make a few, largely ineffectual, telephone calls to the financial institution that holds the mortgage.

I hope that the information I have provided is helpful to your Subcommittee's consideration of this important legislation and to seeking effective means of addressing and preventing foreclosure rescue and loan modification fraud.

Thank you again for the opportunity of sharing the experience of the State Bar of California in dealing with these serious problems.