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PRESENTATION OF THE
OFFICE OF CONSUMER PROTECTION

TO THE SENATE COMMITTEE ON FINANCE

THE TWENTY-SIXTH LEGISLATURE
REGULAR SESSION OF 2012

Wednesday, February 29, 2012
10:00 a.m.

**TESTIMONY ON HOUSE BILL NO. 1875, H.D. 1, RELATING TO FORECLOSURES.**

TO THE HONORABLE MARCUS R. OSHIRO, CHAIR,
AND TO THE HONORABLE MARILYN B. LEE, VICE CHAIR,
AND MEMBERS OF THE COMMITTEE:

The Department of Commerce and Consumer Affairs appreciates the opportunity to testify on H.B. No. 1875, H.D. 1, Relating to Foreclosures. My name is Bruce Kim, Executive Director of the Office of Consumer Protection ("OCP"). OCP supports the intent of the bill and offers the following comments in support of the two-year limit on recorded association liens and the prohibition against foreclosing association liens arising solely from fines, penalties, legal fees or late fees.

In 2010, the Legislature created the Mortgage Foreclosure Task Force ("MFTF") pursuant to Act 162. This year the Task Force through its various working groups

devoted a significant amount of time and effort in attempting to strengthen Act 48. Ultimately, the Task Force's working groups came up with a number of recommendations intended to provide clarity and certainty to lenders, borrowers and associations in the foreclosure process.

I. Two-Year Limit on Recorded Association Liens.

One of the three MFTF working groups this year focused on incorporating non-judicial foreclosures for associations into Chap. 667. Among the final recommendations of the MFTF was to include a two-year limit on **recorded** association liens under Chaps. 421J, 514A and 514B. The MFTF approved this provision unanimously and rejected proposals advocating even longer expiration periods for association liens.

An element of the condominium association lobby has objected to the MFTF's two-year limitation on **recorded** association liens for various reasons. However, these objections should be considered in light of the following facts:

1. The MFTF approved adoption of identical lien and collection language for Chap. 421J associations which have been in effect for Chaps. 514A and 514B associations for many years.

> The task force recommends adding two new sections to chapter 421J, on planned community associations, to provide these associations with the same options as condominium associations with regard to association liens for assessments (modeled after sections 514A-90 and 514B-146) and the collection of unpaid assessments from tenants or rental agents (modeled after sections 514A-90.5 and 514B-145).

Comment 2, Final Report of the Mortgage Foreclosure Task Force to the Legislature for the Regular Session of 2012, at 18.

2. Under the MFTF's lien and collection provision for 421J, Chaps. 421J, 514A, and 514B associations would now have identical **automatic lien** rights which arise without any requirement that the lien be recorded. These **automatic liens** have priority over "all other liens" except for a) tax liens; and b) mortgages that were recorded prior to the recordation of a notice of a lien by the association. *See* H.R.S. § 514b-146(a). The MFTF's two-year expiration limit applies only to "**recorded**" liens, not to automatic liens which are not recorded. However, if an association chose to record its lien then the **recorded** lien would expire after two years.

3. Under Secs. 514A-90, 514B-146, and the MFTF's proposed lien and collection provision for 421J, Chaps. 421J, 514A, and 514B associations do not have to record their lien in order to foreclose on the delinquent unit owner.

> The lien of the association may be foreclosed by action or by nonjudicial or power of sale foreclosure procedures set forth in chapter 667, by the managing agent or board, acting on behalf of the association, in like manner as a mortgage of real property.

H.R.S. § 514B-146(a).

There is no waiting period. Under the automatic lien provisions of 514A-90 and 514B-146, associations can foreclose on their liens from dollar one whether they are recorded or not. Under the MFTF's proposal the automatic lien would be there whether the lien is recorded or not and, if the lien is recorded, even after the two year period has run. The arguments against the two-year lien expiration for **recorded** liens are illusory.

4. According to a review of other state condominium laws, at least 33 states

plus the District of Columbia place similar time limits on association liens. These include Alaska, Arkansas, Arizona, Colorado, Connecticut, Delaware, Florida, Georgia, Idaho, Indiana, Kentucky, Louisiana, Maine, Maryland, Minnesota, Mississippi, Missouri, North Carolina, Nebraska, New Hampshire, Nevada, New Mexico, New York, Ohio, Oregon, Pennsylvania, Rhode Island, Tennessee, Vermont, Virginia, Washington, West Virginia and Wisconsin.

It is not anti-consumer to require associations to timely initiate collection efforts on delinquent association assessments in fairness to the other unit owners in the association and to the individual who is delinquent. It is also not anti-consumer to require that a **recorded** association lien expire by law after two years if the lien has been paid or is no longer under collection by the association. If the association's recorded lien automatically expires after two years, then there is no need for the parties to incur the time and expense of recording a release.

II. No Association May Foreclose Against a Unit Owner Solely for Fines, Penalties, Legal Fees or Late Fees.

The current versions of the House and Senate bills already represent a significant compromise from the MFTF's original recommendations. In the MFTF's report to the legislature, the MFTF's version of lien and collection rights for 421J associations and 514B associations, prohibited any lien, including an "automatic lien", for "any assessments arising solely from fines, penalties, or late fees." The MFTF recommended language was later amended to provide that "no association may

foreclose a lien against any unit that arises solely from fines, penalties, legal fees, or late fees." While some may not regard the change giving associations "automatic lien" rights solely for fines, penalties, legal fees or late fees" as significant, it is. Under existing law associations have a right to initiate collection actions for such "automatic liens" from dollar one regardless of whether the associations record them or not.

There is nothing in the MFTF's original recommendations or the current versions of the House or Senate bills, which alter the existing "pay first dispute later" laws applicable to 514A or 514B associations. Under HRS § 514B-146(c), a unit owner must first pay the association the "full amount claimed by the association" before he or she could file a small claims action or request mediation of a disputed assessment. Under the MFTF's recommendations and the current versions of the House and Senate bills, 421J associations would be afforded identical "pay first dispute later" provisions as 514 A and 514B associations. There nothing in either the MFTF's recommendations or the existing House or Senate bills which change the fact that the unit owner must pay the "full amount claimed by the association" and remain current on all association assessments as a condition precedent to pursue an action in small claims court or submitting their claims to mediation. *See* § 421J-A(d), HB 1875 HD1 at 8.

There is nothing in the current version of the bill, which bars an award of an association's attorneys' fees and costs, etc. where the foreclosure action against the unit owner did not arise "solely" out of claims for fines, penalties, legal fees, or late fees.

Associations would also be free to sue the unit owner and reduce their claims for fines, penalties, legal fees or late fees to a judgment which could be recorded against the unit owner. *See* § 421J-A(a), HB 1875 HD1 at 5.

Thank you for allowing me to testify on this matter. I would be happy to answer any questions the committee may have.

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EVERETT S. KANESHIGE
MORTGAGE FORECLOSURE TASK FORCE CHAIRPERSON

TO THE HOUSE COMMITTEE ON FINANCE

TWENTY-SIXTH LEGISLATURE
Regular Session of 2012

Wednesday, February 29, 2012
10:00 a.m.

**TESTIMONY IN SUPPORT OF HB 1875 HD1: RELATING TO FORECLOSURES**

TO THE HONORABLE MARCUS R. OSHIRO, CHAIR, AND MEMBERS OF THE COMMITTEE:

The Department of Commerce and Consumer Affairs ("DCCA") appreciates the opportunity to testify in support of HB 1875 HD1. My name is Everett Kaneshige, I am the chairperson of the Mortgage Foreclosure Task Force ("MFTF").

As I've noted in prior testimony, this bill is the result of consensus and compromise between the disparate interests of the stakeholders groups represented on the MFTF. Wherever possible the MFTF strove to avoid making policy judgments about the nonjudicial foreclosure law, but instead focused on streamlining the process enacted by the Legislature, and trying to bring to the Legislature's vision of a functional and fair nonjudicial foreclosure process to fruition. The findings and final recommendations of the MFTF focus on addressing nonjudicial foreclosure by condominium and homeowner

associations, revising the Mortgage Foreclosure Dispute Resolution Program to protect personal information and address procedural issues, simplifying definitions and addressing inconsistencies in terminology.

The HD1 under consideration by the Committee addresses concerns from community associations regarding issues arising from enabling community association nonjudicial foreclosures using language borrowed from condominium association law. It also repeals Part I nonjudicial foreclosures (HRS §667-5). The deletion of Part I may necessitate adjusting the timeline of the Mortgage Foreclosure Dispute Resolution ("MFDR") Program so that it will not greatly extend the amount of time needed to complete a Part II nonjudicial foreclosure (HRS §667-22). This can be done by creating an exemption within the stay that goes into effect when participation in the MFDR Program is elected by an owner-occupant (HRS §667-83). The amending language currently in HB 1875 HD1, Section 45, would need to be replaced with the following text:

> "(a) The written notification of a case opening under section 667-79 shall operate as a stay of the foreclosure proceeding[~~,~~] and may be [~~filed or~~] recorded[~~, as appropriate, at the land court or bureau of conveyances.~~]; provided that:
>
> (1) the written notification shall not act as a stay on a foreclosure proceeding by an association unless the association has been provided notice pursuant to sections 667-5.5, 667-21.5, or 667-79; and
>
> (2) the written notification shall not act as a stay on a foreclosure proceeding for the purpose of the date by which the default must be cured pursuant to 667-22(a)(6)."

This replacement would place the previously existing exemption into a new subsection (1), and add a new subsection (2). The effect of this new subsection (2) would be to alter the timeline so that, instead of extending the time needed to complete

a nonjudicial foreclosure under Part II by approximately three months (worst-case scenario), participation in the MFDR Program would add, at most, one month to the process. The Department has conducted an analysis of nonjudicial foreclosure timelines with Part II relative to this issue, and will happily provide it to the Chair, upon request.

In addition to the above, the Department has identified the following potential issues for which it would like to propose amendments for the Committee's consideration:

1. In light of the deletion of Part I, the public information statement drafted by the MFTF is no longer accurate. Specifically, in Section 25, 667-41(b), under "STEP FOUR: DISBURSEMENTS OF PROCEEDS; POTENTIAL DEFICIENCY JUDGEMENT" the following amendment to the HD1 should be made (additions double-underlined, deletions bracketed and stricken):

   "In a NONJUDICIAL FORECLOSURE, the Mortgagee distributes the proceeds from the sale. ~~[If the mortgaged property does not sell for enough to pay off the balance due under your loan, the Mortgagee may have the right to file a lawsuit against you to collect the deficiency. In many cases, after a nonjudicial foreclosure, a Mortgagee cannot or will not choose to file a lawsuit for a deficiency.]~~ Unless the debt is secured by other collateral, or except as otherwise provided by the law, the recordation of both the conveyance document and affidavit shall operate as full satisfaction of the debt."

   The original text had to account for the ability of a foreclosing mortgagee to pursue a deficiency under Part I, in the event that an owner-occupant had a fee simple or leasehold ownership interest in any other real property. As HRS

§667-38 does not permit deficiencies unless the debt is secured by other collateral, the statement as originally drafted would not adequately describe the law.

2. Section 35 of the HD1 is an MFTF amendment that aims to enable the Department to contract with housing counselors and budget and credit counselors to provide services to the consumers participating in the MFDR Program. When it was drafted, an error was made wherein the Department was enabled to contract with "private organizations **or** approved housing counselors **or** approved budget and credit counselors..." (emphasis added). The "or" should have been "and", as "or" implies that the Department may contract with a private organization, or an approved housing counselor, but not both. Therefore the following amendment to the HD1 is requested (additions double-underlined, deletions bracketed and stricken):

> "(c) The department is authorized to contract with county, state, or federal agencies, and with private organizations, [~~or~~] approved housing counselors, and [~~or~~] approved budget and credit counselors for the performance of any of the functions of this part. These contracts shall not be subject to chapter 103D or 103F."

Thank you for this opportunity to testify in support of HB 1875 HD1, DCCA recommends that it be passed, with amendments per the comments above. I will be happy to answer any questions that the Chairperson or members of the Committee may have.

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**The Honorable Marcus R. Oshiro, Chair**
**The Honorable Marilyn B. Lee, Vice Chair**
**House Committee on Finance**

**Hearing : Wednesday, February 29, 2012, 10:00 a.m.**
**State Capitol, Conference Room 308**

**In opposition to HB 1875, HD1 Relating to Foreclosures**

**Chair and Members of the Committees:**

My name is Madeleine Young, representing the Legal Aid Society of Hawai'i ("Legal Aid"). I am advocating for our clients who include the working poor, seniors, citizens with English as a second language, disabled, and other low and moderate income families who are consumers and families facing default and foreclosure on their homes. I provide bankruptcy services as a staff attorney in Legal Aid's Consumer Unit. Specifically, I teach a clinic to show individual consumer debtors how to prepare and file their own petition for chapter 7 bankruptcy relief, as well as provide full representation to Legal Aid clients in bankruptcy matters. I give counsel and advice to clients on protected income sources, exempt assets, and settlement options regarding their consumer debts. I also provide legal services to clients regarding mortgage default and foreclosure matters, wage garnishment avoidance, fair debt collection practices, debt collection defense, as well as student loan, tax debt, and other consumer debt problems.

We are testifying **in opposition** to HB 1875, HD1, which would repeal a key provision in § 667-60, HRS that makes any violation of chapter 667 an unfair or deceptive act or practice ("UDAP") under § 480-2, HRS. Repealing this important provision would seriously weaken protections for mortgage consumers in the State of Hawai'i.

Lenders have cited as the principal reason for their refusal to use the dispute resolution program established under Act 48 the risk of incurring significant UDAP penalties under § 667-60 for "minor violations" of the mortgage foreclosure law. In response to lenders' concerns, 13 of 17 voting members of the Mortgage Foreclosure Task Force ("Task Force") carefully crafted a compromise regarding the UDAP provisions. The Task Force's proposed subsections (a) and (b) of § 667-60 would expressly limit foreclosing mortgagees' UDAP liability only to specifically

delineated Chapter 667 violations. Furthermore, proposed subsection (c) would limit to 180 days the time for filing a court action seeking to void the wrongful transfer of title in a nonjudicial foreclosure. These recommended revisions to § 667-60 address lenders' stated liability concerns but still preserve the most important homeowner protections.

HB 1875 as originally drafted would implement the recommendations of the Task Force, which was established under Act 162 to develop policies and procedures to improve the way mortgage foreclosures are done in Hawai'i. In previous testimony before the CPC and JUD committees, Legal Aid supported the general intent of HB 1875, incorporating the Task Force recommendations to make Act 48 and Hawai'i's foreclosure law more efficient and effective. In making its recommendations, the Task Force worked diligently to address lenders' liability concerns, while ensuring that protections for mortgage consumers were maintained. By contrast, HB 1875, HD1 would remove important UDAP protections for consumers, and thereby make it more difficult for homeowners to establish foreclosure-related UDAP violations.

HB 1875, HD1 would severely diminish existing homeowners' rights and consumer protections by repealing the UDAP provision of § 667-60. For this reason, Legal Aid opposes the bill as amended.

**Conclusion**:

We respectfully request that HB 1875, HD1 receive no further consideration and that you instead approve the Task Force's recommended revisions to § 667-60, which reflect substantial compromise and balance the legitimate interests of homeowners and lenders alike. Thank you for the opportunity to testify.

Hawaii Bankers Association

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Presentation to the Committee on Finance
Wednesday, February 29, 2012 at 10:00 a.m.
Testimony on HB 1875, HD1 Relating to Foreclosures

**In Opposition**

TO: Honorable Marcus R. Oshiro, Chair
Honorable Marilyn B. Lee, Vice Chair
Members of the Committee

I am Gary Fujitani, Executive Director of the Hawaii Bankers Association (HBA), testifying in opposition to HB 1875, HD1. HBA is the trade organization that represents FDIC insured depository institutions operating branches in Hawaii.

While we appreciate the efforts of all members of the Mortgage Foreclosure Task Force and remain sympathetic to those homeowners who are experiencing hardship due to inappropriate behavior by, and difficulty communicating with, their mainland lenders, we respectfully oppose this bill.

We recognize that steps were taken to address lenders' concerns, such as narrowing the scope of potential violations related to Unfair and Deceptive Acts or Practices. However, although modest improvements were incorporated into the Task Force recommendations, the recommendations and other added provisions still make Act 48 unworkable.

Several issues that need to be reconsidered include:

- Allowing the filing of an action to void the foreclosure sale for up to six months after the sale is recorded. This will chill the real estate market and is unwarranted, overly broad and unnecessary.

- Removing the "cap" on the dollar amount on delinquent maintenance fees will likely lead to the unintended consequence of making it more difficult for first-time and middle-income homebuyers to qualify for a loan since it will require more money to complete the purchase.

  This provision is especially damaging to Hawaii borrowers because if the unit is a condominium, the buyer at foreclosure will have to pay the delinquent maintenance fees, and the potential for this liability will inherently be borne by future borrowers. It also makes it more difficult for the condo owner to sell.

- Language specifying the application of rent collected by an Association of Apartment Owners should be included in the bill. It is anticipated due to the extended period of time

for a mortgagee to foreclose, Associations will likely be able to collect rent to cover its delinquent maintenance fees and other costs, therefore, any excess rental income received by the association from the unit should be paid to existing lienors based on priority of lien, and not on a pro rata basis.

- Section 421J-A (page 3) "The **priority of the association's lien shall be as provided in the association documents** or by the date of recordation of the liens, except as otherwise provided by law." needs to be amended. Otherwise, it is implied that the Association's lien is superior to mortgagee's lien regardless of when it was recorded.

- Repealing of nonjudicial foreclosures under Part I, Section 51 of SB 2429, SD1. At a minimum, Part I nonjudicial foreclosures should be permitted for foreclosures of commercial, industrial and investor owned property.
- The provision to hold two open houses is unrealistic as the lender does not have any legal right to take possession of the property and could face unknown potential liability for any action taken to comply with this provision.
- The "attorney affirmation in judicial foreclosure" provision violates attorney client privileges.

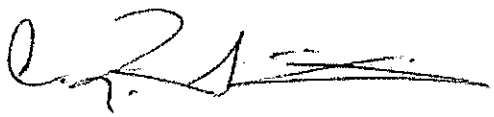
- Repealing section 667-60 should be permanent.

All of the above proposals serve to discourage lenders from utilizing the non-judicial process. We must not lose sight of the fact that funds used to provide mortgages to borrowers come from banks' depositors. As depository institutions, banks have a fiduciary responsibility and obligation to all our depositors that the funds entrusted to us is preserved for future return. What the legislature is proposing no longer serves as a streamlined and fair method of foreclosure for lenders to seek fulfillment of their loan contracts.

Last year, we cautioned that Act 48 would likely result in unintended consequences. Almost immediately upon its passage, Fannie Mae and Freddie Mac issued mandates to lenders to stop all non-judicial foreclosures and switch to the judicial process. Absent any appropriate and immediate remedy, it was evident that our court system would become overburdened and an already lengthy foreclosure process would grow even longer. Additional delays in removing the backlog of foreclosures only prolong a return to a healthy housing market and Hawaii's economic recovery.

The Hawaii Credit Union League, Hawaii Financial Services Association and Hawaii Bankers Association "minority reports" contained in the Task Force report outline additional issues that need to be addressed in the non-judicial foreclosure law. A summary of those combined reports is attached.

Thank you for the opportunity to provide our testimony.



Gary Y. Fujitani
Executive Director

Attachment

Attachment

Summary of Lenders' Issues on Task Force Bill

1. **§667-56 Prohibited conduct:** Repeal of §§667-56(5), -56(6) and -56(7). In all three subsections, the phrase "completing nonjudicial foreclosure proceedings is ambiguous. It is unclear whether that period ends with: recordation of an affidavit of sale; recordation of a conveyance document to the foreclosure sale purchaser; or recovery of possession from the foreclosed mortgagor of the foreclosed property by the purchaser.

(a) Section 667-56(5) also ignores that a lender or servicer may not have notice of a pending short sale escrow at the time of completion of a nonjudicial foreclosure sale. Item (5) attempts to give a potential short sale that is agreed to at or around the time of the non-judicial foreclosure sale priority over the foreclosure so long as the sales price is at least 5% greater than the foreclosure sale price. Recognizing that a sales commission of 6% on the short sale would wipe out the entire 5% increased sales price, the Task Force agreed to increase this percentage to at least 10%. However, this does not address other conditions in the short sale that might have prevented the lender from approving the short sale in the first place, such as payment of other debts of the seller that effectively reduce the amount of the payoff to the lender. This effectively places unsecured creditors ahead of the foreclosing lender and other lien holders

(b) Section 667-56(6) also uses the vague phrase "bona fide loan modification negotiations." If a mortgagor has been denied a loan modification, can the mortgagor then reapply seriatim and maintain the mortgagor's status as pending bona fide loan modification negotiations? Does the time reset each time a mortgagor submits a loan modification request notwithstanding the requests are not materially different than one already denied?

(c) Section 667-56(7) also is too vague because it fails to define with clarity when a mortgagor is being evaluated and when a mortgagor is no longer being evaluated for a loan modification program. This section presumes that there will be timely-issued documentation that a borrower is no longer being evaluated when that is not always the case.

Section 667-60 must be amended to provide clarity to these items and allow the foreclosing lender to end negotiations at some point.

2. **§667-58 Valid notice; affiliate statement**: (a) As worded, the subsection implies mortgagee/lender must file affiliate statements naming their own officers. A suggested amendment to begin as follows:

> Any notices made pursuant to this chapter may be issued only by the foreclosing mortgagee or lender, or by a person identified by the foreclosing mortgagee or lender in an affiliate statement signed by that foreclosing mortgage or lender and recorded . . . .

3. **§667-59 Actions and communications with the mortgagor in connection with a foreclosure**: Besides the obvious proof problems and violation of the parol evidence rule, this section is directly counter to the express stated provisions in virtually all notes and mortgages which require any revision to the existing terms to be in writing. This section should be amended to include the words "in writing," in the first sentence so that it will read as follows:

> "A foreclosing mortgagee shall be bound by all agreements, obligations, representations, or inducements to the mortgagor, which are made **in writing** by its agents, including but not limited to its . . . ."

4. **§667-60 Unfair or deceptive act or practice; transfer of title**: The Task Force attempted to correct one of the more problematic provisions in Act 48 Sec. 667-60 states: "Any foreclosing mortgagee who violates this chapter shall have committed an unfair or deceptive act or practice under section 480-2." It unnecessarily subjects lenders to the liabilities in HRS Sec. 480-2 for even immaterial and nonsubstantive violations of HRS Chapter 667 (Mortgage Foreclosures). HRS Sec. 667-60 has been cited as one of the reasons why lenders decided after May 5, 2011 to foreclose judicially rather than non-judicially. This section should be repealed.

Instead, the Task Force recommended that Sec. 667-60 be changed to: (a) create a "laundry list" of 21 violations which would be unfair or deceptive acts or practices (including 7 items in Sec. 667-56 and 4 items related to the Mortgage Foreclosure Dispute Resolution Program), (b) create 17 violations which could result in a non-judicial foreclosure sale being voided, and (c) allow actions to void the foreclosure sale to be filed up to 6 months after an affidavit of the sale is recorded. This recommendation is arguably unwarranted and overly broad. Lenders likely will continue not to use non-judicially foreclosure process and consequently not use the dispute resolution program.

5. **§667-85 Neutral qualifications; status and liability**: Reads in part: "A neutral shall not be a necessary party to, called as a witness in, or subject to any subpoena duces tecum for the production of documents in any arbitral, judicial, or administrative proceeding that arises from or relates to the mortgage foreclosure dispute resolution program." This sentence should be repealed. A neutral in the Mortgage Foreclosure Dispute Resolution Program should not be immune from testifying if the neutral makes findings or determinations which subject a lender or a borrower to sanctions.

6. **§667-80 Parties; requirements; process**: This section should be amended to permit mainland lenders to attend during reasonable business hours where they are situated. Additionally, provision must be made to accommodate situations where approval of a loan modification requires more than one approval. For example, in instances where mortgage insurance is in place, the insurer will be required to approve the modification in addition to the lender.

7. **§667-41 Public information notice requirement**: While improved tremendously by the proposed amendment approved by the Task Force, this section still potentially applies to certain commercial loans in which residential property is taken as collateral. It is doubtful that the Legislature intended this informational notice to apply to commercial borrowers and applicants and requests that the Legislature, in addition to adopting the proposed revisions made the Task Force, also enact a further amendment to specify that such notice requirement applies only to consumer, residential mortgage loans.

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Testimony to the House Committee on Finance
Wednesday, February 29, 2012

Testimony in opposition to HB 1875 HD1, Relating to Foreclosures

To: The Honorable Marcus Oshiro, Chair
The Honorable Marilyn Lee, Vice-Chair
Members of the Committee on Finance

My name is Stefanie Sakamoto, and I am testifying on behalf of the Hawaii Credit Union League, the local trade association for 81 Hawaii credit unions, representing approximately 811,000 credit union members across the state. We are in opposition to HB 1875 HD1, Relating to Foreclosures.

While we understand the current economic situation, and the plight of homeowners today, we oppose this measure. We recognize and appreciate the efforts of the legislature to amend Act 48 to address some concerns raised by lenders, however, this bill continues to present many significant concerns for Hawaii's credit unions, and the lending market as a whole. We have listed these concerns below.

1. The League opposes the repeal of nonjudicial foreclosures under Part I. The Part I non-judicial foreclosure process should continue to exist as a viable alternative to the Part II non-judicial foreclosure process now that Act 48 strengthened consumer protections in Part I. Act 48 now (a) requires that Part I foreclosure notices be served at least 21 days before the auction date, (b) specifies that the service of the notice be in the same manner as serving civil complaints, (c) enables an owner-occupant to convert a Part I non-judicial foreclosure to a judicial foreclosure or to elect dispute resolution under certain circumstances, and (d) prohibits a lender in a Part I non-judicial foreclosure from pursuing a deficiency against certain owner-occupants. At a minimum, Part I nonjudicial foreclosures should be permitted for foreclosures of commercial, industrial and investor-owned property, if not for owner-occupied residential property.

2. Because of the increasing costs being charged by certain newspapers of daily circulation in Hawaii to print the notices of judicial and non-judicial foreclosure auctions required to be "published", the League supports the Legislature's efforts to have a state agency provide a centralized internet website for the official posting of notices required by Chapter 667.

3. The League opposes the lifting of the cap on an association's super-lien for maintenance fees. It was originally capped at the lesser of 6 months of $3,200. Under Act 48, that cap lifted to the lesser of 12 months or $7,200. Now, the super-lien is simply six months of

monthly assessments with no monetary cap. This cost will eventually be borne by the next private buyer of the unit, and will effectively depress prices for units in the project.

4. **§ 667-41**: While the League agrees that the proposed amendment of § 667-41 is a tremendous improvement, the section still potentially applies to certain commercial loans in which residential property is taken as collateral. The League believes that the Legislature did not intend this informational notice to apply to commercial borrowers and applicants. The League asks that the Legislature, in addition to adopting the revisions proposed by the Task Force, also amend § 667-41 to specify that such notice requirement applies only to consumer, residential mortgage loans.

5. **§667-56**: Prohibited practices: The League seeks repeal of §§667-56(5), -56(6) and -56(7). In all three subsections, the phrase "completing nonjudicial foreclosure proceedings is ambiguous. It is unclear whether that period ends with: recordation of an affidavit of sale; recordation of a conveyance document to the foreclosure sale purchaser; or recovery of possession from the foreclosed mortgagor of the foreclosed property by the purchaser.

(a) Section 667-56(5) also ignores that a lender or servicer may not have notice of a pending short sale escrow at the time of completion of a nonjudicial foreclosure sale.

(b) Section 667-56(6) also uses the phrase "bona fide loan modification negotiations." This phrase is vague, and raises many questions, such as: If a mortgagor has been denied a loan modification, can the mortgagor then reapply time after time and maintain the mortgagor's status as "pending" bona fide loan modification negotiations? Does the time reset with each mortgage loan modification request notwithstanding the requests are not materially different than one already denied?

(c) Section 667-56(7) also is too vague because it fails to define with clarity when a mortgagor is being evaluated and when a mortgagor is no longer being evaluated for a loan modification program. Section 667-56(7) presumes that there will be timely-issued documentation that a borrower is no longer being evaluated when that is not always the case.

6. **§667-58**: As worded, § 667-58(a) implies credit unions must file affiliate statements naming their own officers. The League suggests § 667-58(a) be amended to begin as follows:

> "Any notices made pursuant to this chapter may be issued only by the foreclosing mortgagee or lender, or an officer of the foreclosing mortgagee or lender, or by a person identified by the foreclosing mortgagee or lender in an affiliate statement signed by that foreclosing mortgage or lender and recorded . . . ."

7. **§667-59**: The League suggests that this section, captioned, "Actions and Communications with the Mortgagor in Connection with a Foreclosure," should be amended to include the words "in writing," in the first sentence so that it will read as follows:

> "A foreclosing mortgagee shall be bound by all agreements, obligations, representations, or inducements to the mortgagor, which are made in writing by its agents, including but not limited to its . . . ."

8. **§ 667-60**: The League submits that the proposed amendment of § 667-60 is too complex and overly broad. Section 667-60 now states: "Any foreclosing mortgagee who violates this chapter shall have committed an unfair or deceptive act or practice under section 480-2." The requirement that a claimant must show a court proof that an act was "unfair and deceptive" is removed. Any violation of Chapter 667, no matter how miniscule, becomes an unfair and deceptive act or practice entitling the claimant to certain remedies and damages, and that includes voiding of the contract or agreement. Section 667-60 is often cited as one of the principal reasons why lenders decided after May 5, 2011 to foreclose judicially rather than non-judicially.

The amendment of §667-60 proposed by this bill should not be enacted because:

(a) It would create a "laundry list" of violations which would be unfair or deceptive acts or practices,

(b) It would create violations which could result in a non-judicial foreclosure sale being voided, and

(c) It would allow actions to void the foreclosure sale to be filed up to 6 months after an affidavit of the sale is recorded.

The League submits that the proposed amendment is too complex and overly broad and it would continue to discourage lenders from foreclosing non-judicially. It is also unnecessary. Every lender is already subject to potential liability under §480-2 where someone has evidence sufficient to convince a court that a violation occurred.

9. Section 4 of the bill adds a new section to Chapter 667, requiring an attorney affirmation before a foreclosure can be pursued. This new section is unnecessary because adequate safeguards already exist. This provision also would potentially violate attorney-client privilege.

In addition to the concerns listed above, we also concur with the issues raised by the Hawaii Bankers Association and the Hawaii Financial Services Association. Thank you for the opportunity to testify.

HAWAIIAN COMMUNITY ASSETS

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**House Committee on Finance**
**Wednesday, February 29, 2012, 10:00 a.m.**
**State Capitol, 415 South Beretania Street**
**Conference Room 308**

**HB1875, HD1: SUPPORT INTENT AND PURPOSE**

Chair Oshiro, Vice Chair Lee, and Committee Members,

My name is Noelle Kai Desaki, Community Services Manager with Hawaiian Community Assets, a HUD-approved housing counseling agency that provides free foreclosure prevention counseling services through our statewide offices. Based on our reach and impact in community, Hawaiian Community Assets held representation on that State Mortgage Foreclosure Task Force since its inception in 2010.

Hawaiian Community Assets supports the intent and purpose of HB1875, HD1 as a vehicle for implementing the 2012 recommendations of the State Mortgage Foreclosure Task Force as well as repealing Part I of chapter 667 and requiring attorneys instituting residential judicial foreclosure actions to file affirmations regarding the accuracy of submitted documents. However, Hawaiian Community Assets strongly opposes and highly cautions the repeal of section 667-60 until the dispute resolution program ends and then implementing the 667-60 compromise included in the Task Force Recommendations.

**Passing of Act 48 and UDAP provision key in slowing the alarming rate of foreclosure we faced in 2010.** I would like to take this opportunity to remind ourselves of the foreclosure crisis we faced last year which prompted the passing of Act 48, including the strong Unfair and Deceptive Acts and Practices provisions that have been the primary line of defense giving our families breathing room and ourselves a chance to reflect with regards to foreclosures in our communities. At the time of the passing of Act 48, Center for Responsible Lending reports showed that our State had seen a 687% increase in foreclosure filings between the third quarter of 2006 and the first quarter of 2010 resulting in a loss of approximately $15 billion in home equity for our families – an average loss per home of $41,668. During our counseling work, we saw the impacts of a lending industry that never had to modify loans on such a widespread basis – submitted paperwork was being reported as lost or never received, families' mortgage payments were not being recorded, repayment plans would be agreed upon and changed when the family would receive the approval paperwork, and we struggled alongside families to simply make contact with lenders from the Continent. As a result of implementing Act 48 and the UDAP provision, on January 11, 2012 RealtyTrac reported that the number of foreclosures in Hawaii had dropped by 52% from the year prior.

I want to stop there and caution us to be too optimistic. **Should the State Legislature remove the UDAP provision as reflected in HB1875, HD1, we would undermine all the hard work**

**and dedication of the State Legislature and Task Force members of the last 2 years by taking away language that makes lenders as accountable as homeowners during the foreclosure process.** To eliminate section 667-60 as a way to call the bluff of unscrupulous lenders would only harm our homeowners and go against the intent of the Task Force's 2012 recommendations. Such action would further damage the abilities of our homeowners to prevent foreclosure at a time when Center for Responsible Lending projects that our nation will experience a second round of adjustable rate mortgage resets at the end of 2012 into 2013.

**Hawaiian Community Assets strongly opposes elimination of section 667-60 for the stated reasons above and to maintain the language as recommended by the Task Force.**

**Working together to address rampant unfair and deceptive acts and practices.** Our organization has recently received funding to support the free Independent Foreclosure Review process initiated through the National Mortgage Settlement. The Reviews are to determine whether or not homeowners, who were in foreclosure between January 1, 2009 and December 31, 2010, experienced "financial injury". This process was established in light of the rampant "robo-signing" scandals that came to light in the fall of 2011, which resulted in Bank of America, the lender responsible for 98% of Hawaii home foreclosures in November 2010, in halting their foreclosure operations in all 50 states. The non-judicial foreclosure process, a process that is outlawed in 20 states throughout our nation, was viewed as the primary vehicle for such blatant unfair and deceptive acts and practices to take place since the process requires no third-party mediator or judge, no check-and-balance to verify all required documents were held by the lender at time of initiating the foreclosure.

**By repealing Part 1 of Chapter 667 and requiring attorneys instituting residential judicial foreclosure actions to file affirmations regarding the accuracy of submitted documents we have the opportunity to learn from past mistakes and unchecked fraudulent behavior, which unfortunately led to the wrongful foreclosure of Hawaii families' homes.** These inclusions in HB1875, HD1, combined with community-based outreach and public education efforts, can help provide our future generations with the opportunity to fulfill a dream of homeownership in Hawaii so they can set their roots in their home land and raise a family.

Thank you for your time and consideration.

Sincerely

Noelle Kai Desaki
Community Services Manager

HAWAII CHAPTER
community
ASSOCIATIONS INSTITUTE

P.O. Box 976
Honolulu, Hawaii 96808

February 28, 2012

Honorable Marcus R. Oshiro
Honorable Marilyn B. Lee
415 South Beretania Street
Honolulu, Hawaii 96813

Re: HB 1875 HD1

Dear Chair Oshiro, Vice Chair Lee and Committee Members:

I chair the CAI Legislative Action Committee. CAI remains concerned about HB 1875 HD1. Broadly speaking, significant concerns relate to:

1. The substantial change in law to the effect that no association may foreclose a lien that arises solely from fines, penalties, legal fees or late fees;

2. The policy of lien expiration and the language chosen to implement that policy;

3. Notwithstanding certain provided alternatives, the requirement to "serve" lien creditors (as opposed to the owner) according to the rules of civil procedure;

4. The length of the redemption period;

5. The length, and consequent publication expense, of the public notice;

6. Importation of the inapplicable concept of loan acceleration into the realm of association assessments; and

7. Miscellaneous matters.

CAI respectfully requests that the Committee consider certain legal precedent relating to an association's need to have an enforcement capacity, and to note that current law provides an available adequate remedy for owners who dispute assessments, contained in H.R.S. Section 514B-146(d). Those precedents and Section 514B-146(d) are referenced in an attachment.

Very truly yours,

Philip S. Nerney

ATTACHMENT TO CAI TESTIMONY RE: HB 1875 HD1

Condominium law is premised on a pay first, dispute later basis. Thus, Hawaii Revised Statutes ("H.R.S.") Section 514B-146(c) begins: "No unit owner shall withhold any assessment claimed by the association." The owner's remedy is found in Section 514B-146(d):

> (d) A unit owner who pays an association the full amount claimed by the association may file in small claims court or require the association to mediate to resolve any disputes concerning the amount or validity of the association's claim. If the unit owner and the association are unable to resolve the dispute through mediation, either party may file for arbitration under section 514B-162; provided that a unit owner may only file for arbitration if all amounts claimed by the association are paid in full on or before the date of filing. If the unit owner fails to keep all association assessments current during the arbitration, the association may ask the arbitrator to temporarily suspend the arbitration proceedings. If the unit owner pays all association assessments within thirty days of the date of suspension, the unit owner may ask the arbitrator to recommence the arbitration proceedings. If the owner fails to pay all association assessments by the end of the thirty-day period, the association may ask the arbitrator to dismiss the arbitration proceedings. The unit owner shall be entitled to a refund of any amounts paid to the association which are not owed.

Adoption of HB 1875 HD1 would be severely prejudicial to the financial viability of associations. A solid premise for the pay first, dispute later approach is demonstrated in the following cases:

"**Because homeowners associations would cease to exist without regular payment of assessment fees**, the Legislature has created procedures for associations to quickly and efficiently seek relief against the non-paying owner." (Emphasis added) Park Place Estates Homeowners v. Naber, 29 Cal. App. 4th 427, 432, 35 Cal. Rptr. 2d 51, 53 (Cal. App. 4 Dist. 1994)(denying an owner's claimed right to withhold assessments due to a grievance).

In Park Place East Condo. v. Hovbilt, 279 N.J. Super. 319, 323, 652 A.2d 781, 783 (N.J. Super. Ch. 1994), the court noted: The legislative scheme for collection of assessments for maintenance charges against individual unit owners is a recognition that **such charges are the financial life-blood of the Association**. They are conceptually akin to the right of a municipality to levy and collect real estate taxes. The legislature clearly did not intend that the necessary income stream be reduced by the payment of 'reasonable attorneys fees' incurred in the process of collection of the charges. [footnote omitted] (emphasis added)

Inwood Condominium Association v. Winer, 49 Conn. 694, 696, 716 A.2d 139, 140 (Conn. App. 1998) presented the case of a condominium owner who opposed an Association's summary judgment motion in its foreclosure action by "claiming that the amount due was in dispute. He claimed that the amount due to the plaintiff for assessments and common charges had been tendered to it but not accepted and that, therefore, the only remaining sums allegedly due were for attorney's fees. The defendant claimed that such fees are not recoverable until a judgment has entered." The court disagreed. It *affirmed* the foreclosure judgment. 49 Conn. at 698, 716 A.2d at 141.

Mountain View Condominium Association v. Bomersbach, 734 A.2d 468 (Pa. Cmwlth. 1999), appeal dismissed 564 Pa. 433, 768 A.2d 1104 (2001), is another case in point. In that case, an owner declined to pay $500.00 in attorney's fees in connection with an effort to collect $1,200.00. The court affirmed a $46,548.64 attorney's fee award. That case involved an owner who had a "trench warfare philosophy[.]" 734 A.2d at 471. The court quoted the trial court's decision, which included the following:

> The Association had the option of either backing off or enforcing its rights under the Declaration and the decisional law. The fact that it elected not to compromise, to stand on principal [sic] and to uphold the law requires that its attorney's fees be covered. **Any holding to the contrary would cause chaos in Condominium Associations whose compliant members would have to bear the cost of dealing with non-compliant members.** . . .The Association had no choice, in this writer's view, but to pursue its legally correct position. It has done so and is entitled to be reimbursed for the expenses of doing so. 734 A.2d at 471 (emphasis added)

Inwood Condominium Association v. Winer, 49 Conn. 694, 696, 716 A.2d 139, 140 (Conn. App. 1998) presented the case of a condominium owner who opposed an Association's summary judgment motion in its foreclosure action by "claiming that the amount due was in dispute. He claimed that the amount due to the plaintiff for assessments and common charges had been tendered to it but not accepted and that, therefore, the only remaining sums allegedly due were for attorney's fees. The defendant claimed that such fees are not recoverable until a judgment has entered." The court disagreed. It *affirmed* the foreclosure judgment. 49 Conn. at 698, 716 A.2d at 141.

Nottingdale Homeowner's Association v. Darby, 33 Ohio St.3d 32, 36, 514 .N.E. 2d 702. 706 (Ohio 1987)(superseded by statute) clearly demonstrates that adoption of HB 1875 HD1 would severely hamper collection efforts. After noting that the owner in that case contracted freely to be bound by the condominium declaration, and that the owner enjoyed the services paid at common expense, it stated:

> No amount of legal wrangling can obscure the fact that appellees knowingly accepted the services and must pay for them. To obtain this inevitable result, appellant has been forced by appellees' intransigence to incur large amounts in attorney's fees to collect the relatively small amount of past due assessments. [footnote omitted] By refusing to enforce the provision which would require appellees to pay appellant's reasonable attorney fees, this court would make it virtually impossible for condominium unit owners' associations to recoup unpaid assessments from recalcitrant unit owners. **The expense of collection would render the effort useless.** The result would be that a unit owner, who for any reason does not wish to pay his monthly service assessment, can enjoy the benefits of such services and refuse to pay for them, secure in the knowledge that collection by the association will be prohibitively expensive. **Under such circumstances, what incentive would exist for the unscrupulous unit owner to pay his assessments? Obviously, very little.**
>
> As can be seen, the fee-shifting agreement in this case protects the fund of the unit owners' association from potential bankruptcy, and the conscientious contributors thereto from the burden of paying for the delinquency of others. Without such fee-shifting arrangements, unit owners' associations may have to abandon claims against

> debtors, such as appellees, as too costly to pursue. *With* such agreements, the debtor will be encouraged to pay to avoid litigation, and if litigation becomes necessary, the association's resources will be protected if its suit proves meritorious. A more ideal arrangement can scarcely be imagined. (Italics in original. Other emphasis added)

*Cf.* Springs Condominium Association, Inc. v. Harris, 297 Ga. App. 507, 677 S.E.2d 715 (Ga.App. 2009)(belated tender of amounts did not defeat mandatory attorney's fee award); BA Mortgage, LLC v. Quail Creek Condominium Association, 192 P.3d 447 (Colo.App. 2008)(declaration and statute mandated attorney's fee award); and Fortenberry Professional Building v. Zecman, 581 So. 2d 972 (Fla.App. 5 Dist. 1991)(attorney's fee award to association mandatory in foreclosure action despite owner prevailing on counterclaim). One salient point to be gleaned from the foregoing cases is that cases such as the instant case are about ***governance***, and the Association's essential *need* to maintain the integrity of the system. Thus, in Mozley v. Prestwould Board of Directors, 264 Va. 549, 557, 570 S.E.2d 817, 821-22 (Va. 2002), the court noted that "the Board was confronted with litigation that could have had a significant negative impact on its procedures and methods of operation. Thus, in the words of the chancellor, '[h]aving initiated the proceeding, [Mozley] cannot now complain that defendant and its counsel took [the suit] too seriously.'" (Editing in original) The owner in that case had contended that the Association could not collect fees because she paid an assessment *after* the association filed a summary judgment motion; but the court disagreed.

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February 29, 2012

**The Honorable Marcus R. Oshiro, Chair**
House Committee on Finance
State Capitol, Room 308
Honolulu, Hawaii 96813

**RE: H.B. 1875, H.D.1, Relating to Foreclosures**

**HEARING: Wednesday, February 29, 2012, at 10:00 a.m.**

Aloha Chair Oshiro, Vice-Chair Lee, and Members of the Committee:

I am Myoung Oh, Government Affairs Director, testifying on behalf of the Hawai'i Association of REALTORS® ("HAR"), the voice of real estate in Hawai'i, and its 8,500 members. HAR **submits comments and requests a proposed amendment** on H.B. 1875, H.D.1, which implements the recommendations of the mortgage foreclosure task force to address various issues relating to the mortgage foreclosure law and related issues affecting homeowner associations.

HAR sincerely appreciates the efforts of the Mortgage Foreclosure Task Force to make recommendations regarding the existing foreclosure law in Hawai'i. However, the HAR has concerns that some of these recommendations may create unintended adverse consequences if it becomes law.

***Moratorium on Non-Judicial Foreclosures***
HAR understands that, since the enactment of Act 48, non-judicial foreclosures have essentially stopped, and lien holders have opted to pursue the more costly and lengthy judicial foreclosure route. This issue appears to be linked, in part to the stringent Unfair or Deceptive Acts and Practices (UDAP) provisions in Act 48. The mortgage industry and even Fannie Mae have cited UDAP as one of the primary reasons for noncompliance with the legislative intent of Act 48. Until certain UDAP provisions that apply to non-judicial foreclosures are clarified, HAR believes that it may be prudent to continue a moratorium on Part I and even Part II non-judicial foreclosures.

HAR believes that non-judicial foreclosures should exist as a mechanism only if it is fair and balanced for both the borrower and creditor. HAR believes that, in the meantime, court oversight via the judicial foreclosure process should continue to be utilized as the only foreclosure mechanism and be only limited to owner-occupants.

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***Foreclosure Recovery for Homeowner Associations***

HAR strongly supports the expansion of the condominium foreclosure law to cover planned community associations so that planned community associations are able to obtain relief due to unpaid common assessments as a form of recovery from foreclosure. Moreover, HAR supports the concept of a new section to establish an alternate power of sale process for homeowner and condominium associations for unpaid liens and assessments. We recognize that this section may need refining, and defer to the appropriate parties on specifics.

***HRS Section 667-60 – Oppose 180-Day Waiting Period (Page 46)***

Under Page 46 of H.B. 1875, H.D.1, the Task Force recommends that a 180-day waiting period be implemented after a foreclosure sale, to allow the foreclosed borrower to bring forth any claims for invalidating the public auction sale. HAR has concerns that the imposition of the 180-day requirement would severely impact the ability of a bidder to be able to purchase foreclosed real estate at auction. This will discourage potential bidding from the public at large, because, among other reasons, the waiting period will make it challenging to obtain financing. Owner occupant financing usually contains a requirement that a buyer take occupancy of the property within 30-90 days of closing the loan/purchase. If a Buyer cannot occupy a property within the lender's guidelines, the loan is categorized as an "investor loan," which requires a much larger down payment and a higher interest rate.

The California civil code sections regarding bona fide purchaser protections have worked for many years and could provide guidance for this Committee to consider. In California, the law presumes that the lender has satisfied requirements relating to notification, the auction sale, and all other aspects of the foreclosure. The lender is liable for financial damages to the mortgagor if the sale is overturned, but the third-party bidder is protected. In short, the California system encourages competitive bidding at the auction, fosters competition that will yield the highest possible sale price, and creates the opportunity for the homeowner who lost the property to recover funds in the event there is an overbid.

Based on the foregoing, if the Committee is inclined to move this bill forward for further discussion, HAR would recommend that the 180-day waiting period only apply in situations where the lender takes back the property at auction with a credit bid, but that a third-party purchaser be exempted from this requirement.

For the forgoing reasons, HAR respectfully ask this Committee to consider the attached amendments to protect third-party purchasers, while still preserving consumer protection for homeowners.

Mahalo for the opportunity to testify.

(D) Completing a nonjudicial foreclosure if a neutral's closing report under section 667-82 indicates that the foreclosing mortgagee failed to comply with requirements of the mortgage foreclosure dispute resolution program;

(9) Completing a nonjudicial foreclosure while a stay is in effect under section 667-83;

(10) Failing to distribute sale proceeds as required by section 667-31;

(11) Making any false statement in the affidavit of public sale required by section 667-32; and

(12) Attempting to collect a deficiency in violation of section 667-38.

(b) Notwithstanding the provisions of subsection (a), any failure to comply with the provisions of this chapter shall not affect the validity of a sale in favor of a bona fide purchaser or the rights of an encumbrancer for value without notice. The statements in the recorded affidavit required by section 667-5 or section 667-32, as applicable, shall be conclusive evidence as to the facts stated therein for any purpose, in any court and in any proceeding, and in favor of a bona fide purchaser and encumbrancer for value without notice. The purchaser of the mortgaged property, other than the foreclosing mortgagee, shall be conclusively presumed to be a bona fide purchaser. Encumbrancers for value include lenders and holders of liens who provide the purchaser with purchase money in exchange for a mortgage or other security interest in the newly-conveyed property. [~~the~~] A transfer of title to the [~~purchaser of the property~~] foreclosing mortgagee as a result of a foreclosure under this chapter shall only be subject to avoidance under section 480-12 for violations described in sections (a)(1) to (9)

if such violations are shown to be substantial and material; provided that a foreclosure sale shall not be subject to avoidance under section 480-12 for violation of section 667-56(5).

(c) Without limiting the provisions of subsection (b), [~~A~~]any action to void the transfer of title to the purchaser of property under this chapter shall be filed in the circuit court of the circuit within which the foreclosed property is situated no later than one hundred eighty days following the recording of the affidavit required by section 667-5 or section 667-32, as applicable. If no such action is filed within the one hundred eighty-day period, then title to the property shall be deemed conclusively vested in the purchaser free and clear of any claim by the mortgagor or anyone claiming by, through, or under the mortgagor.

MORTGAGE BANKERS ASSOCIATION
2004 ADJUNCT ORGANIZATION

*Mortgage Bankers Association of Hawaii*
*P.O. Box 4129, Honolulu, Hawaii 96812*

February 29, 2012

The Honorable Marcus R. Oshiro, Chair, and
Members of the House Committee on Finance
State Capitol, Room 308
Honolulu, Hawaii 96813

Re: House Bill 1875, HD 1 Relating to Foreclosures

Chair Oshiro and Members of the House Committee on Finance:

I am Mark James, representing the Mortgage Bankers Association of Hawaii ("MBAH"). The MBAH is a voluntary organization of real estate lenders in Hawaii. Our membership consists of employees of banks, savings institutions, mortgage bankers, mortgage brokers, and other financial institutions. The members of the MBAH originate the vast majority of residential and commercial real estate mortgage loans in Hawaii. When, and if, the MBAH testifies on legislation, it is related only to mortgage lending.

The MBAH opposes House Bill 1875, HD 1 Relating to Foreclosures. We support and endorse the positions contained in the testimony of the Hawaii Bankers Association.

We likewise believe that the contents of House Bill 1875, HD 1 will discourage use of the non-judicial foreclosure process. We believe that this will have an adverse affect on lending and borrowers' ability to borrow funds and will delay Hawaii's real estate recovery.

We ask that you hold this measure.

Thank you for the opportunity to present this testimony.

MARK JAMES
President, Mortgage Bankers Association of Hawaii

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February 28, 2012

*Via Email: Capitol Web Page*

Representative Marcus R. Oshiro
Chair, Committee on Finance
Hawaii State Capitol, Room 306

Re: H.B. 1875, HD1 –Relating to Foreclosures
Hearing: Wednesday, February 29, 2012 at 10:00 a.m., Agenda #1.
Conference Room 308

Dear Chair Oshiro and Members of the Committee on Finance:

I am Michael Wong, an attorney with RCO Hawaii LLLC ("RCO Hawaii"), a law firm dedicated to the representation of the mortgage banking and default servicing industry. Our firm provides a wide range of services in banking and real estate law to more than 200 large and small companies located in several Western states, including Alaska, Idaho, Arizona, Washington, Oregon, California, Nevada and Hawaii. It also serves as retained counsel for Fannie Mae in Hawaii.

RCO **submits comments** regarding H.B. 1875, HD1, Relating to Foreclosures, which implements the recommendations of the Mortgage Foreclosure Task Force, and makes numerous other changes to the Hawaii foreclosure law.

RCO specifically supports the amendments made in H.B. 1875, HD1, which change the publication requirements for non-judicial foreclosures to a "newspaper of general circulation" and provide guidelines for qualifying as such a newspaper. This approach, which has been implemented in other states, ensures that a newspaper meets general circulation requirements, and that there is an opportunity for more than one paper to compete to publish non-judicial foreclosure notices.

Since the passage of Act 48, 2011 Session Laws of Hawaii, non-judicial foreclosure notices were required to be published in a "daily newspaper having the largest general circulation in the county where the property is located. . . " (emphasis added). Prior to Act 48, both in the Hawaii foreclosure laws and elsewhere in the Hawaii Revised Statutes, the publication of notices only required publication in a "newspaper of general circulation." Due to the inclusion of the terms "daily" and "largest," there has been a dramatic increase in the costs for publishing notice on

Oahu, in the largest and only daily paper available.1 Specifically, in a review of our judicial foreclosure publication costs in Hawaii between 2008 through the end of 2011, we found that the average advertising cost per foreclosure was $800 in 2008, but costs $2,000 today. This amounts to a 150% increase between 2008 and 2011. Moreover, if non-judicial foreclosures begin to take place pursuant to Act 48 and any changes that are made to the law this session, non-judicial foreclosure notices (which are significantly longer than judicial foreclosure notices) may cost up to $4,300 per foreclosure.

RCO believes the amendments made in H.B. 1875, HD1 ensure that there is fair competition for the publication of notices. This also ultimately reduces harm to the borrower, to whom the resulting dramatic increase in cost would be passed.

RCO understands that there may be other alternatives to accomplish public notice, and remains willing to engage in further discussion and to provide input, based upon its experiences in Hawaii and other states.

Thank you very much for the opportunity to testify regarding this measure.

[1] While the Act 48 publication requirements apply only to non-judicial foreclosures, Hawaii courts have found Act 48 to be instructive, and have applied these requirements to judicial foreclosures.

# HAWAII FINANCIAL SERVICES ASSOCIATION

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February 29, 2012

Rep. Marcus R. Oshiro, Chair
and members of the House Committee on Finance
Hawaii State Capitol
Honolulu, Hawaii 96813

Re: **House Bill 1875, HD 1 (Foreclosures)**
**Hearing Date/Time: Wednesday, February 29, 2012, 10:00 a.m.**

I am Marvin Dang, the attorney for the **Hawaii Financial Services Association** ("HFSA"). The HFSA is a trade association for Hawaii's consumer credit industry. Its members include Hawaii financial services loan companies (which make mortgage loans and other loans, and which are regulated by the Hawaii Commissioner of Financial Institutions), mortgage lenders, and financial institutions.

The HFSA **opposes this Bill as drafted.**

The purposes of this Bill are to: (a) implement the 2011 recommendations of the Mortgage Foreclosure Task Force to address various issues relating to the mortgage foreclosure law and related issues affecting homeowner association liens and the collection of unpaid assessments; (b) repeal the non-judicial foreclosure process under Part I of HRS Chapter 667; (c) following the expiration of the Mortgage Foreclosure Dispute Resolution program in 2014, specify certain foreclosure violations as unfair or deceptive acts or practices, limit the types of violations that may void a title transfer of foreclosed property, and establish a time limit for filing actions to void title transfers of foreclosed property.

I served as the Vice Chair of the Hawaii Mortgage Foreclosure Task Force ("Task Force") from 2010 to the present. I was a member of the Task Force as the designee of the HFSA. This testimony is not on behalf of the Task Force and it is not in my capacity as the Vice Chair of the Task Force.

The Task Force, which was created by Act 162 of the 2010 Session Laws of Hawaii, issued its Preliminary Report to the 2011 Legislature and its Final Report to the 2012 Legislature. There were various issues on which the 18 Task Force members were divided. These issues are detailed in the "minority reports" attached to the Report for the HFSA, the Hawaii Bankers Association, and the Hawaii Credit Union League.

This testimony of the HFSA incorporates by reference the concerns raised in those three "minority reports" about some of the Task Force's recommendations.

This HFSA testimony also incorporates by reference the testimony which we understand is being submitted by the Hawaii Bankers Association and the Hawaii Credit Union League detailing the reasons for concerns about various provisions in this Bill.

This Bill needs to be revised, at a minimum, as follows:

1. Do not repeal the non-judicial foreclosure process under Part I of HRS Chapter 667. The Task Force did not recommend the repeal. The Part I non-judicial foreclosure process was already enhanced by consumer protection provisions in Act 48 (2011). Part I should at least be available for use by mortgage lenders for non-homeowner foreclosures.

2. Delete the proposed changes in HRS Sec. 667-60 beginning on page 44, line 15, and on page 156, on lines 3 and 4. These provisions would mandate that when the Mortgage Foreclosure Dispute Resolution Program expires in 2014, there would be certain foreclosure violations specified as unfair or deceptive acts or practices, there would be a limit on the types of violations that may void a title transfer of foreclosed property, and there would be a time limit for filing actions to void title transfers of foreclosed property. These changes should be deleted because the repeal of HRS 667-60 (unfair or deceptive act or practice) in Section 62 of this Bill (page 153, lines 7 and 8) should not be dependent on whether there is a Mortgage Foreclosure Dispute Resolution Program. This Section would permit a court action to be brought to void the transfer of title after a non-judicial foreclosure sale. The court action could be filed up to 180 days after the transfer of title. This provision will have the negative consequence of discouraging third parties from bidding at reasonable price levels at non-judicial foreclosure auctions.

3. Delete the requirement in Part II of HRS Chapter 667 for staging "open houses" or "public showings" prior to the public sale (auction) in non-judicial mortgage foreclosures. The references to be deleted in Part II are in HRS Secs. 677-21, 667-22, 667-26, 667-27, and 667-32. It should be noted that the non-judicial foreclosure process being proposed for condominium associations and planned community associations in this House Draft 1 version of this Bill specifically deleted such an open house requirement from the original version of this Bill. Deleting this requirement in Part II for mortgage foreclosures is needed because of the legal impediment of obtaining access to the property to conduct open houses and because of the potential liability connected with such open house showings.

4. Delete the attorney affirmation provision for judicial foreclosures beginning on page 47, line 1, through page 48, line 34. We understand that the Hawaii State Bar Association is submitting testimony expressing concerns about this provision because of attorney-client privilege and confidentiality issues. Existing court rules, such as the Hawaii Rules of Civil Procedure and the Hawaii Supreme Court's Rules of Professional Conduct governing attorneys, already provide enforcement remedies for problems that this attorney affirmation provision purports to address.

5. Reinstate the monetary cap in HRS Sec. 514A-90(h) and HRS Sec. 514B-146(h). This cap is on the total amount of unpaid common area maintenance fees that a condominium association may specifically assess against a person who purchases a foreclosed unit. The amount of the cap is currently $7,200 based on 12 months of delinquent maintenance fees. The lack of a reasonable monetary cap could make it challenging for consumers to obtain mortgage financing for condominium units.

6. Enable notices of non-judicial foreclosure public sales (auctions) under Part II of HRS Chapter 667 (HRS Sec. 667-27(d)) to be published either (a) in a newspaper of at least "weekly" circulation (instead of newspapers of "daily" circulation) or (b) on a website maintained by a state government entity such as the Department of Commerce and Consumer Affairs. This Bill has the first alternative, but not the second alternative. Both of these alternatives are needed because of the current high cost of publishing notices in newspapers of daily circulation.

We also ask that your Committee put in a "defective" effective date in this Bill to encourage further discussion.

Thank you for considering our testimony.

Marvin S.C. Dang

MARVIN S.C. DANG
Attorney for Hawaii Financial Services Association

(MSCD/hfsa)

**LAW OFFICE OF GEORGE J. ZWEIBEL**
**45-3590A Mamane Street**
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**(808) 775-1087**

**House Committee on Finance**

**Hearing: Wednesday, February 29, 2012, 10:00 a.m.**
**Conference Room 308, State Capitol, 415 South Beretania Street**

**IN SUPPORT OF INTENT AND PURPOSE OF HB 1875, HD1**

**Chair Oshiro, Vice Chair Lee, and Committee Members:**

My name is George Zweibel. I am a Hawaii Island attorney and have for many years represented mortgage borrowers living on Oahu, Hawaii, Kauai and Maui. Earlier, I was a regional director and staff attorney at the Federal Trade Commission enforcing consumer credit laws as well as a legal aid consumer lawyer. I have served on the Legislature's Mortgage Foreclosure Task Force ("Task Force") since its inception in 2010, although the views I express here are my own and not necessarily those of the Task Force.

**I generally support HB 1875, HD1 to the extent it implements the 2012 recommendations of the Task Force as well as repealing Part I of chapter 667 and requiring attorneys instituting residential judicial foreclosure actions to file affirmations regarding the accuracy of submitted documents. I strongly oppose repealing § 667-60 (declaring that any violation of chapter 667 violates § 480-2) until the dispute resolution program ends and then implementing the § 667-60 compromise included in the Task Force recommendations. Further, I respectfully urge the Committee to revise HB 1875, HD1 by: (1) repealing the dispute resolution program sunset, and (2) allowing borrowers to participate in dispute resolution before they must decide whether to convert to a judicial foreclosure. Finally, to avoid undermining the intent and effectiveness of Act 48 and current law, it is important to retain: (1) specific reference to the FDIC loan modification guidelines in the dispute resolution program; (2) mortgagee liability for oral misrepresentations made on mortgagees' behalf; and (3) mortgagee liability for completing a foreclosure after a loan modification has been approved or while one is being considered.**

1. **Immediately implement the Task Force's recommended § 667-60 amendments.** By expressly stating that any chapter 667 violation constitutes an unfair or deceptive act or practice ("UDAP") under § 480-2, § 667-60 is of fundamental importance because it both deters violations of the foreclosure law *and* provides meaningful remedies if they occur. This helps prevent wrongful

foreclosure, *e.g.*, when servicers make mistakes or fail to honor loan modification agreements, and ensures that important borrower rights are honored, including dispute resolution and conversion of nonjudicial to judicial foreclosures.

Lenders contend that § 667-60 may subject them to disproportionate penalties for trivial violations of chapter 667. The Task Force recommendations directly respond to this concern in two ways. First, they recommend creating several "safe harbors," *e.g.*, providing a public information notice form lenders can use to comply with § 667-41 and clarifying where foreclosure notices must be published. Second, the Task Force recommends limiting the applicability of § 667-60 to listed chapter 667 violations that are most likely to result in wrongful foreclosure and/or financial harm. Voiding a transfer of title under § 480-12 would be further limited to the most serious of those violations, and a court action seeking such relief would have to be filed within 180 days. The Task Force's recommended revision of § 667-60 was approved by 13 of the 17 voting members.

I have today submitted (and attach and incorporate) separate written testimony opposing HB 2018, HD1, which would repeal § 667-60 in its entirety and delay implementation of the Task Force compromise version of § 667-60 until after the dispute resolution program is scheduled to end (see below). This would drastically reduce existing homeowner rights and protections and encourage widespread noncompliance with Chapter 667. Instead, I respectfully request that the Committee approve immediate implementation of all of the Task Force's recommended § 667-60 revisions, without changes, which reflect substantial compromise and strike a fair balance between lenders' stated concerns regarding liability for minor violations and the need to protect borrowers from irreparable harm caused by serious chapter 667 violations.

**2. <u>Repeal sunset of dispute resolution program</u>**. Under Act 48, the dispute resolution program currently is scheduled to end on September 30, 2014. Although the program has been available since October 1, 2011, mortgagees have stopped doing nonjudicial foreclosures in Hawaii, based on their perceived risk of undue liability under § 667-60. Consequently, mortgagees' decision to stop doing nonjudicial foreclosures will reduce to considerably less than the intended three years the period during which dispute resolution is actually available. On the other hand, by facilitating negotiations between owner-occupants and mortgagees to determine whether a loan modification or other agreement avoiding foreclosure is possible, the dispute resolution program will benefit homeowners and loan holders alike for as long as it exists. For these reasons, the sunset provision in Act 48 should be repealed.

**3. <u>Repeal requirement that borrowers choose between dispute resolution and conversion</u>**. Foreclosure dispute resolution and converting a nonjudicial foreclosure to a judicial foreclosure are both extremely important rights. However, they serve different purposes and borrowers should not be

forced to choose between them. Conversion allows borrowers to assert legal claims and defenses in a court of law which, if established, may prevent a wrongful foreclosure and afford other relief. In contrast, dispute resolution creates a process for determining whether foreclosure can be avoided by reaching a mutually beneficial agreement, *e.g.*, by modifying loan terms, irrespective of whether legal foreclosure defenses may exist. Alternative dispute resolution should be encouraged and utilized to the greatest possible extent, but not at the expense of forfeiting the conversion right if an agreement cannot be reached. Instead, the homeowner should retain the option, in the event dispute resolution is unsuccessful, to move the foreclosure to court so that a judge can still decide whether valid foreclosure defenses exist.

4. **Repeal Part I nonjudicial foreclosure.** I support HB 1875, HD1's repeal of Part I of chapter 667. When the moratorium on new nonjudicial foreclosures under Part I expires on July 1, 2012, Hawaii would again have two very different but overlapping nonjudicial foreclosure laws. With the Task Force's 2012 recommended revisions, Part II will embody the best efforts of lender and borrower representatives as well as the Legislature to craft a fair, comprehensive and effective Hawaii nonjudicial foreclosure law. There is no reason for Part I to continue to provide for an inferior alternative nonjudicial foreclosure process and it should be repealed.

5. **Retain judicial foreclosure attorney affirmation requirement.** HB 1875, HD1 would require attorneys who file residential foreclosure actions to certify in writing that they have verified the accuracy of the documents submitted. Such due diligence by plaintiffs' attorneys would help prevent well-publicized problems involving failure to review loan documents establishing standing and other foreclosure requisites, filing notarized affidavits falsely attesting to such review and other material facts, and "robosigning" of documents. A recent foreclosure audit in San Francisco County strongly suggests that the true magnitude of this problem – in Hawaii and elsewhere – is much greater than previously realized. Casting doubt on the validity of almost every foreclosure it examined, that audit determined that *84%* contained law violations, with 2/3 having at least four violations or irregularities. New York Times, Feb. 16, 2012, at A1, A3. Transfers of many loans were made by entities that had no right to assign them and institutions took back properties in auctions even though they had not proved ownership. In *45%* of the reviewed foreclosures, properties were sold at auction to entities improperly claiming to be the beneficiary of deeds of trust (used instead of mortgages to secure residential loans in California). In *6%* of the foreclosures, the same deed of trust was assigned to two or more different entities, raising questions about who actually had the right to foreclose. Many securitized foreclosures showed gaps in the chain of title, indicating that transfers from the original loan owner to the entity currently claiming to own the deed of trust have disappeared.

Hawaii would not be the first state to require attorneys to certify that they have personally verified their clients' legal right to foreclose. The New York State Unified Court System instituted this requirement in October 2010, stating in its press release that it was adopting an attorney affirmation requirement "to protect the integrity of the foreclosure process and prevent wrongful foreclosures" and that the new filing requirement "will play a vital role in ensuring that the documents judges rely on will be thoroughly examined, accurate, and error-free before any judge is asked to take the drastic step of foreclosure." The proposed Hawaii attorney affirmation form is nearly identical to the one used in New York.

Courts in two of Ohio's largest counties, Cuyahoga County (where Cleveland is located) and Franklin County (where Columbus is located) have issued Case Management Orders requiring mortgagees' lawyers in residential foreclosure cases to ascertain and certify the accuracy of the facts and documents provided to the court. Although Ohio foreclosure attorneys objected to attorney affirmation requirements based on purported attorney-client concerns (*i.e.*, compelling them to "breach" clients' attorney-client privilege and their ethical obligations regarding confidentiality of client information), the courts there have not modified the Case Management Orders and in April 2011 the Ohio Supreme Court refused to order them to do so.

The foreclosure attorney affirmation requirement in HB 1875, HD1, like those already in place in New York and Ohio (and possibly other states), would go far toward ending systematic foreclosure abuses and wrongful foreclosure in Hawaii.

6. **Retain use of FDIC loan modification guidelines in foreclosure dispute resolution program**. Section 667-80(e) mandates use of the calculations, assumptions and forms established by the Federal Deposit Insurance Corporation loan modification program (or a different program or process if the parties and neutral agree). The Task Force considered but rejected recommending removal of the specific reference to the FDIC guidelines, because that program is widely regarded as the most objective, transparent and verifiable loan modification program in widespread use. Retention of the FDIC language in § 667-80(e) will help avoid mistakes and ensure that the "net present value" calculation accurately determines whether it is more beneficial for the loan holder to modify the loan or to foreclose. Conversely, its deletion would seriously undercut the dispute resolution program's ability to achieve its intended goal.

7. **Retain mortgagee liability for oral misrepresentations**. Lenders have proposed amending § 667-59 so that foreclosing mortgagees would be bound only by written agreements and representations made on their behalf. Consumer protection law enforcement agencies and private consumer attorneys have long recognized that most misrepresentations are oral and not put into writing, making them much easier to deny later. Contrary to general rules of evidence, proof of oral misrepresentations usually is permitted to establish UDAP

or fraud claims. Lenders' proposed change would eliminate foreclosing mortgagees' legal responsibility for all oral misrepresentations made by their representatives. There can be no justification for giving anyone a "license" to commit fraud, especially when families' homes are at stake.

8. **Retain mortgagee liability for foreclosing during consideration or after approval of loan modification**. Lenders have proposed repealing § 667-56(6) and (7), which prohibit completing a foreclosure during loan modification negotiations or after acceptance into a federal loan modification program. There have been many instances in which mainland servicers have completed foreclosures while loan modifications were being considered or while trial or permanent modifications were in effect. Retaining § 667-56(6) and (7) is essential to protect Hawaii homeowners from such abuses and the obvious harm they cause.

Thank you for your consideration of my testimony.

February 28, 2012

Representative Marcus R. Oshiro, Chair
Representative Marilyn B. Lee, Vice Chair
Members of the Committee on Finance
Twenty-Sixth Legislature
Regular Session, 2012

Re: H.B. 1875
Hearing on Wednesday, February 29, 2012, 10:00 a.m.
Conference Room 308

Dear Chair, Vice-Chair and Members of the Committee:

My name is Ann Baran. I am the Senior Director of Resort Operations for Trading Places International the managing agent for the Hanalei Bay Resort in Princeville, Kauai and strongly oppose H.B. 1875. The Hanalei Bay Resort consists of seventy-seven timeshare units and thirty-four whole owner units. Condo associations play a key part in providing housing for the State's population and any bill that diminishes their ability to collect delinquent maintenance fees and dues will not only have an adverse effect, it will penalize all other owners in the association and will, as a result, hurt the long term sustainability of housing in Hawaii

Thank you for the opportunity to testify on House Bill No. 1875.

Sincerely,

Ann Baran

## FINTestimony

**From:** mailinglist@capitol.hawaii.gov
**Sent:** Tuesday, February 28, 2012 12:25 PM
**To:** FINTestimony
**Cc:** gomem67@hotmail.com
**Subject:** Testimony for HB1875 on 2/29/2012 10:00:00 AM

Testimony for FIN 2/29/2012 10:00:00 AM HB1875

Conference room: 308
Testifier position: Oppose
Testifier will be present: No
Submitted by: Eric M. Matsumoto
Organization: Mililani Town Association
E-mail: gomem67@hotmail.com
Submitted on: 2/28/2012

Comments:
This bill hurts the 99 percent of homeowners in PCAs in order to protect the 1 percent and is contradictory for the following reasons:

1. Page 2, Lines 9-14: Section 2 421J-A(3)(a)specifies a lien expiration after 2 years unless renewed. This short itmeline will result in forcing PCAs to expend memebers dues monies unnecessarily, just to satisify some individual's misconception that it wuld help the 1 percent, but rather would result in costing the 99 percent additional dollars.

. Page 8, Line 12 on: Section 2, 421J-A(e) specifies boards may terminate a delinquent's acess to common areas, but Page 9, Line 1 Section 2, 421J-A(f) requires the board first develop a policy to be voted upon by the memebrs. MTA would be hard pressed to get 51% of the 15, 850+ memebers to either app[rove or deny this policy. If the intent is to provide the action, either give it unconditinally or take it out.

3. Page 11, Line 19: Sectin 2, 421J-B(a) specifies a process for collecting assessments from tenents, but Page 13, Line 20, 421J-B(g) requires the board first develop a policy IAW 421J-B(a) and have the policy approved by a majority of the members. Again, MTA, woould be hard pressed to get 51% of the 15,850+ memebers to to respond either for or against. The question then becomes why even have the provision of 421J(a)? Either put it in or take it out without condidtions.

We request this bill be held.

HSBA
Hawaii State Bar Association

Testimony of the
HAWAII STATE BAR ASSOCIATION

TO: Honorable Marcus R. Oshiro, Chair
Honorable Marilyn B. Lee, Vice Chair
House Committee on Finance

FROM: Carol K. Muranaka
President, Hawaii State Bar Association

RE: **House Bill 1875, House Draft 1 (Foreclosures)**

Hearing: Wednesday, February 29, 2012, at 10:00 a.m.



Mr. Chair, Vice Chair Lee, and Members of the Committee, I have been authorized by the Board of the Hawaii State Bar Association to offer these comments regarding the proposed provision relating to attorney affirmations in judicial foreclosure cases.

The HSBA takes no position on H.B. No. 1875, HD 1, as a whole, with the exception of serious concerns we have about the proposed provision relating to attorney affirmation in judicial foreclosure, the section highlighted in the attachment hereto.

A note in the draft legislation indicates the apparent legislative intent of the proposed affirmation:



1100 Alakea Street, Suite 1000 • Honolulu, HI 96813 • Phone: (808) 537-1868 • Fax: (808) 521-7936 • http://HSBA.org

> *Note: During and after August 2010, numerous and widespread insufficiencies in foreclosure filings in various courts around the nation were reported by major mortgage lenders and other authorities, including failure to review documents and files to establish standing and other foreclosure requisites; filing of notarized affidavits which falsely attest to such review and to other critical facts in the foreclosure process; and "robosignature" of documents.*

The provision is of concern to the HSBA because:

1. Existing safeguards embedded in the Hawai`i Rules of Professional Conduct and the Hawai`i Rules of Civil Procedure (Rule 11), promulgated by the Hawai`i Supreme Court that govern the conduct of attorneys, are adequate to address the concerns of the proposed provision;

2. The proposed provision improperly affects the client's right of confidentiality by forcing the attorney to be a material witness who, under the Hawai`i Rules of Professional Conduct, may be forced to withdraw from representation on conflict of interest grounds and negatively affects the attorney/ client relationship, by forcing the litigating attorney for the creditor to potentially be some kind of an expert witness as to the ultimate factual issue in the case if an issue of the validity of the contract is involved; and

3. Does not accomplish the apparent legislative intent.

## I. <u>Existing safeguards</u>

The standards for attorney conduct within the attorney-client relationship and before the courts have largely been the province of ethics rules promulgated by

the Judiciary, not the Legislature. Stepping into this area by the Legislature raises serious concerns as to separation of powers.

Existing rules prohibit an attorney from engaging in "frivolous action." Similarly, court rules expose an attorney to monetary sanctions and penalties for engaging in frivolous conduct. Haw. R. Civ. P. Rule 11 and F. R. Civ. P. Rule 11. Ethics rules define as a "frivolous action" (as to factual matters) where "the client desires to have the action taken primarily for the purpose of harassing or maliciously injuring a person or if the lawyer is unable either to make a good faith argument on the merits of the action taken or to support the action taken by a good faith argument for an extension, modification or reversal of existing law." Comment [2], Haw. R. P. C. 3.1.

In representing a client before a tribunal, ethics rules dictate that,

> (a) a lawyer shall not knowingly:
>
> (1) make a false statement of material fact or law to a tribunal;
>
> (2) fail to disclose a material fact to a tribunal when disclosure is necessary to avoid assisting a criminal or fraudulent act by the client; [or]
>
> * * *
>
> (4) offer evidence that the lawyer knows to be false. If a lawyer has offered material evidence and comes to know of its falsity, the lawyer shall take remedial measures to the extent reasonably necessary to rectify the consequences.

Haw. R.P.C. 3.3.

The "Scope" discussion to the Hawai`i Rules of Professional Conduct also makes clear that violation of the Rules exposes an attorney to serious sanctions:

> [5] Failure to comply with an obligation or prohibition imposed by a rule is a basis for invoking the disciplinary process. The rules presuppose that disciplinary assessment of a lawyer's conduct will be made on the basis of the facts and circumstances as they existed at the time of the conduct in question and in recognition of the fact that a lawyer often has to act upon uncertain or incomplete evidence of the situation. Moreover the rules presuppose that whether or not discipline should be imposed for a violation, and the severity of a sanction, depend on all the circumstances, such as the willfulness and seriousness of the violation, extenuating factors and whether there have been previous violations.
>
> [6] Violation of a rule should not give rise to a cause of action nor should it create any presumption that a legal duty has been breached. The rules are designed to provide guidance to lawyers and to provide a structure for regulating conduct through disciplinary agencies. They are not designed to be a basis for civil liability. Furthermore, the purpose of the rules can be subverted when they are invoked by opposing parties as procedural weapons. The fact that a rule is a just basis for a lawyer's self-assessment, or for sanctioning a lawyer under the administration of a disciplinary authority, does not imply that an antagonist in a collateral proceeding or transaction has standing to seek enforcement of the rule. Accordingly, nothing in the rules should be deemed to augment any substantive legal duty of lawyers or the extra-disciplinary consequences of violating such a duty.
>
> [7] Moreover, these rules are not intended to govern or affect judicial application of either the attorney-client or work product privilege except insofar as those rules provide otherwise. Those privileges were developed to promote compliance with law and fairness in litigation. In reliance on the attorney-client privilege, clients are entitled to expect that communications within the scope of the privilege will be protected against compelled

> disclosure. The attorney-client privilege is that of the client and not of the lawyer. The fact that in exceptional situations the lawyer under the rules has a limited discretion to disclose a client confidence does not vitiate the proposition that, as a general matter, the client has a reasonable expectation that information relating to the client will not be voluntarily disclosed and that disclosure of such information may be judicially compelled only in accordance with recognized exceptions to the attorney-client and work product privileges.

The proposed requirement of an attorney affirmation appears to be based on a perception that the sanctions rules in place are insufficient to deter alleged frivolous conduct that supposedly pervades the foreclosure crisis. Yet there is no empirical or credible evidence that increasing an attorney's duty of inquiry and his/her exposure (civil, criminal and professional) will ameliorate the abuses that are the focus of the proposed new regulation. There are no other statutes or causes of action where attorneys are directly held to a standard higher than non-frivolousness – a standard not clearly or objectively defined. The danger here is that the attorney's zealous representation of the client can be dulled by the attorney's desire to protect him/herself from liability, which in turn will have a negative impact on that attorney's obligation to faithfully represent the client.

## II. Violation of attorney client confidentiality and material witness/party to foreclosure litigation

More importantly, the proposed required affirmation requires the attorney to divulge the contents of communication with a representative(s) of his/her client. It

is difficult to perceive the rationale for that intrusion into the principle of confidentiality that is a cornerstone of the attorney client relationship.

A standard verification of a pleading requires the signer to swear to the accuracy of the *pleading*, but not the factual accuracy of (presumably) all "documents and records" relating to the case.

- Must the representative(s) examine the original mortgage and each check forwarded by the mortgagor and the postmark or other proof of the date of delivery (which goes to the calculation of late charges, *etc.*)? Is the representative to audit the accounts listed to attest to the accuracy of all entries, to assure that there were no typographical or other unintentional errors?
- More fundamentally, the question is how does the required affirmation cure the problem identified in the Note? If client representatives are willing to submit false documents under oath, why wouldn't they similarly lie to their attorney, when questioned about what records they reviewed and whether the contents of notarized documents are accurate?
- And if it turns out that the plaintiff's papers are somehow inaccurate, notwithstanding the client's statement of accuracy to the attorney, has the attorney been placed in a position that he/she will potentially be a witness in a perjury prosecution against his/her own client?

But, in addition to the client's statement to the lawyer that those writings were accurate and proper, the required affirmation requires more: the lawyers "own inspection and other reasonable inquiry." Apparently, when it comes to foreclosure cases, an attorney is not entitled to rely on his/her client alone; the attorney is required to inspect the client's records, and to make other inquiry reasonable under the circumstances (beyond the inquiries specifically required to