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Barnett Sivon & Natter P.C.
ATTORNEYS at LAW
WASHINGTON, DC

Fundamental Questions Raised by "Term Sheet"*

Robert Barnett

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Mortgage servicing is the issue du jour, and proper standards for it have become a question of discussion in many departments of government. One effort presents more than an ordinary set of questions. That is the effort best known by the anonymously authored document labeled "Settlement Terms" (03/03/11) ("Term Sheet").

For those of us not intimately involved in the discussion around this document, we have to assume it refers to a settlement of some actual or prospective disputes in which one side is represented by one or more Attorneys General and the other by one or more servicer. What we don't have before us is any description or documents which articulate exactly what dispute is being settled by this term sheet; whether the dispute is the same with all parties; what the prospective damages might be; whether there is agreement on facts by either party; what kind of protection is provided, or limitations placed on the actions of, either party to subsequent lawsuits by them or other third parties; whether the plaintiffs are planning to commence similar actions against other servicers if this one is settled; and how non-parties to the proceedings are effected. We, therefore, comment with some trepidation.

What is clear from the document itself, however, is that it is a major statement about which standards are appropriate for servicing mortgages, it contains extensive detail about the definition of such standards and the operation of them in practice, and a clear statement that material violations of any provision in the 27 pages is an unfair and deceptive trade practice and a breach of the (newly established in this document) duty of good faith and fair dealing.

The interesting question raised is the appropriateness of this kind of proceeding. This is different from the question of whether it is legal, in a

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constitutional sense, although that too is an interesting question for constitutional scholars to debate. It's a more basic question - should the government impose rules on society through enforcement actions as opposed to normal legislative or regulatory actions.

This is not an easy question to answer. Examples abound of cases in which enforcement actions were used to change conduct of an industry in ways that most members of society believe are appropriate, notwithstanding the method used. Cigarette lawsuits were effective in leading to various governments imposing smoking bans. Single premium credit insurance was effectively removed as a mortgage product following enforcement actions against one originator. There are other examples.

At the same time, the basic construction of our government relies upon a separation of powers and a balancing of powers between the three major branches of government. Otherwise, there remains the possibility that over time one of the three branches becomes subordinate to one or both of the other two.

As part of that doctrine, branches of government should take great care in encroaching upon the fields of responsibility of other branches. The executive branch should avoid creating new laws through interpretations of vague, ambiguous or non-existent statutes. The legislative branch should avoid passing laws that effectively detail the administration and operation of parts of the government bureaucracy. The judiciary branch should address the cases before it, not cases that are not before it or issues that are not before it in the particular case with which it is dealing.

These are straight forward doctrines with which most would agree. But sometimes there are disagreements on specific cases.

The issue raised by the Term Sheet is complex. It appears to be a mingling of state and federal power, even though it is not exactly clear how that would be done. Federal agencies, including the Department of Justice and Treasury (through the offices of the CFPB), as well as State Attorneys General, are reputed by some media stories to be participants in the discussions.

The Term Sheet itself covers a very wide variety of servicing issues and creates new filing requirements, training requirements, foreclosure processes requirements, modification requirements, delays in exercising rights of ser-

vicers, creation of new technical equipment and processes, apparently modifications in existing contracts, and new rules for quality control with third parties, to mention a few.

It mandates for the functional equivalent of the cram down of principal payments in bankruptcy, notwithstanding that that had been explicitly rejected in the last Congress. It makes policy decisions on which homeowners will receive benefits and which will not, and on what groups will the burden of taxation or higher mortgage prices fall.

But from the perspective of the Iowa Attorney General, if he feels that he has a legitimate cause of action against one or more of the parties with whom he is negotiating a settlement, why should he not try to implement procedures that he, in his own mind, feel are the right ones for his state. If the citizens of the state don't like that, they can toss him out if he is elected, and toss out his Governor if he is appointed by the governor.

The governor is not restricted by the federal Constitution's separation of powers — he is of course restrained by the restrictions on what is within his state AG jurisdiction. But the point is the same as with the federal officials involved — is this the appropriate way to limit actions of citizens and parse out the burdens of homeownership among them?

From the perspective of any federal agency involved, isn't the establishment of best practices for mortgage servicing sufficiently prescriptive and invasive of a broad array of the rights of individuals and businesses that the better way to discuss it is through normal regulatory procedures that have notice and comment periods and permit the public to participate? Every homeowner that does not receive a principal write down, and particularly those whose houses are worth less than their mortgages, is being discriminated against by these procedures. The changes in procedures mandated are so many and extensive, that costs to prospective homeowners will likely be increased. Costs to the taxpayer will increase. All of these seem to be sufficiently significant that a broad array of the public should have an opportunity to register their opinion on the changes.

Congress saw fit to include in the Dodd-Frank Act an entire subtitle on mortgage servicing, so considering and reaching decisions with respect to mortgage servicing is not a subject that Congress is reluctant to undertake. Utilizing enforcement actions to adopt regulatory and, in some cases (see

the bankruptcy mortgage cram down language), legislative changes can reasonably be argued to be a step past some line in the sand and into arbitrary executive branch action or even into the jurisdiction of the legislative branch.

The authors of the Federalist papers were landowners who were particularly concerned that the popularly elected Congress would become tyrannical and absorb the powers and rights of the other two branches. The principal author on these issues, Mr. Madison, was anxious to make it clear that while this was a danger, some overlap between the branches was acceptable pointing out that the Senate should be the judge on impeachment trials, for example, thereby explaining some of the comments of Montesquieu who famously said, "There can be no liberty where the legislative and executive powers are united in the same person, or body of magistrates." But those instances were instances in which those overlapping rights are established in the Constitution. Here we have encroachment in a more devious way — achieving legislative and regulatory goals through use of enforcement actions. It's too bad Mr. Madison didn't address that question as he reviewed basic questions of separation of powers and appropriateness of government actions.

Robert Barnett is a partner with the law firm of Barnett Sivon & Natter, P.C.