BOOT CAMP: Foreclosure and Loan Workout Procedures

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BOOT CAMP: Foreclosure and Loan Workout Procedures

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Submitted by Emily Cowles

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I. Loan Modifications

a. Programs and Incentives Available

1. Types of loan modifications

There are several options that may be available to the borrower when he or she faces financial hardships but wishes to stave off foreclosure. These options can take several forms:

a. **Forbearance** takes place when a lender reduces or "forebears" payments for the borrower, often due to a temporary financial hardship on the part of the borrower. Unlike other loan modifications, the lender will recoup the suspended payments after the forbearance period has elapsed through installments or a lump sum. The lender may require other modifications in conjunction with amending the term.

b. **Capitalization of arrears** allows the borrower to combine all past due payments and any fees or other charges and adds them to the balance of the loan. This brings the borrower current, but it raises the amount of future payments.

c. **Interest rate reductions** decrease the interest rate of the loan either temporarily or permanently, but interest income that would have been derived from that higher interest may be added to the loan principal.

d. A **loan extension** is a change in the term length of a loan, allowing for smaller payments a borrower can more easily afford over a longer time period.

e. FHA-insured loans in which the borrower is at least four months delinquent can apply for a **partial claim**, which will turn missed payments due to a documented hardship into a no-interest second mortgage that becomes due when the property is sold or refinanced.

f. **Principal deferral** reduces the amount of principal paid off with each payment, reducing the payment. Deferred principle is due when the loan matures or the property is sold or refinanced.

g. **Repayment plans** allow the borrower to get current with payments and fees, usually starting with a payment of a percentage of the delinquent amount and then increased mortgage payments until the mortgage is current.

h. **“Deed in Lieu”** of foreclosure allows the borrower to transfer the property (residential or commercial)_directly to the lender instead of proceeding with the foreclosure process. The lender may agree to waive the deficiency balance of the borrower’s debt.

2. Current Federal Programs

There are a multitude of federal programs that rely on various techniques above to modify loans and keep borrowers out of foreclosure:

a. HAMP – Home Affordable Mortgage Program

HAMP came about as part of the economic stimulus packages of 2008 and 2009 and was created by the Treasury Department as a way to stabilize the housing market and provide a uniform system of loan modification for all lenders and borrowers. The basic gist of HAMP is that it will reduce monthly mortgage payments to 31 percent of verified monthly gross income for borrowers whose payments exceed that percentage. HAMP is currently set to expire on December 31, 2016. Several of the following programs fall under the HAMP umbrella with similar criteria and lender/investor incentives.

HAMP Tier 1 modifications are available for loans on owner-occupied residences that have not participated in a HAMP modification. HAMP Tier 2 applies to rental properties or those who lost good standing on a Tier 1 modification or defaulted under a Tier 1 Trial Period Plan.

i. Criteria for eligibility:

I. Loans originated on or before January 1, 2009

II. First-lien loans on owner-occupied properties

III. Unpaid principal balance of up to $729,750

IV. Borrowers must be current or less than 60 days delinquent and in imminent default, or 60 days or more delinquent

V. Full monthly payments (principal, interest, taxes, insurance) cost more than 31% of the borrower's gross monthly income

VI. Income must be documented, and borrower must sign an affidavit of financial hardship

VII. The servicer must participate in HAMP

ii. Incentives for borrowers:

I. HAMP borrowers are eligible for a $1,000 yearly principal reduction bonus for keeping payments current

II. HAMP borrowers in good standing for six years will receive a one-time payment of $5,000 applied to their loan's principle balance

iii. Incentives for servicers:

I. Each completed loan modification earns the servicer compensation of between $900-2100, depending on how delinquent the borrower is – the more delinquent the borrower, the less of a compensation incentive to the servicer, thus encouraging servicers to act quickly.

II. Servicers may also receive an annual pay-for-success payment up to $1,000 for each of three years if a borrower's monthly payment is reduced by 6% or more through HAMP

Tier 1 if the loan is in good standing and has not been paid off.

iv. Incentives for investors – if a borrower enters into a permanent modification, investors may be entitled to certain incentives:

I. A "payment reduction cost share" incentive that is based on the reduction in the borrower's payment

II. A "current borrower" incentive of $1,500 if the monthly payment was reduced by at least 6% and the borrower was current on mortgage payments at the time of the modification

b. PRA - Principal Reduction Alternative

PRA helps underwater homeowners by providing incentives to servicers and investors to reduce the principle on the home. Over a three-year period, a borrower can earn a principle reduction, with a PRA forbearance amount reduced by one-third every year the borrower remains in good standing. If the borrower loses good standing, the remaining principal forbearance that has not been forgiven becomes due when the property is sold or financed or at the end of the loan term. PRA is administered as part of HAMP.

i. Criteria:

I. The property must be underwater with a loan to value ratio greater than 115%

II. The loan is NOT owned or guaranteed by Fannie Mae or Freddie Mac (other modifications under HAMP are available to those homeowners)

III. The home is the borrower's primary residence

IV. Loan originated on or before January 1, 2009

V. Unpaid principal balance of up to $729,750

VI. Full monthly payments (principal, interest, taxes, insurance) cost more than 31% of the borrower's gross monthly income

c. 2MP – Second Lien Modification Program

If a borrower's first mortgage was modified under HAMP, a second mortgage on the property may be eligible for a modification as well under this program.

i. Incentives for servicers:

I. Servicers receive a one-time payment of $500 for each 2MP modification

II. They may also receive an annual pay-for-success fee of $250 for each of three years if the borrower's mortgage payment on the second lien mortgage is reduced by a minimum of 6%

III. If a second mortgage balance is entirely extinguished in a 2MP modification, the servicer receives a payment of $500 if the unpaid balance equaled $5,000 or more and the monthly payment on the mortgage was $100 or more

ii. Incentives for investors:

I. Investors may receive a payment reduction cost share based on how much the borrower's payment was reduced

II. An extinguishment incentive may be applicable in some cases if the second mortgage is extinguished

d. HARP - Home Affordable Refinance Program

HARP allows borrowers who are current on their mortgage but who are underwater on their homes to refinance through the program. This makes mortgages on underwater properties more affordable.

i. Criteria

I. Loan owned by Fannie Mae or Freddie Mac

II. Loan originated on or before May 31, 2009

III. Loan-to-value ratio must be greater than 80%

IV. Borrower is current on payments

V. Home is a primary residence, a second home or a 1- to 4-unit investment property

e. FHA2LP – Treasury/FHA Second Lien Program

Similar to 2MP, if the servicer of the first mortgage on a home agrees to participate in FHA Short Refinance, the second mortgage may be reduced or eliminated through FHA2LP. The total amount of the mortgage debt after a refinance under this program cannot exceed 115% of the home's current value.

f. UP – Home Affordable Unemployment Program

UP supplements HAMP for unemployed borrowers by reducing or suspending their monthly mortgage payment.

i. Criteria:

I. Loan is a first lien mortgage, originated on or before January 1, 2009

II. At least one unit must be borrower's principle residence

III. Unpaid principle no greater than $729,750 (for one unit properties)

IV. Loan hasn't been previously modified under HAMP or received a UP forbearance period

V. Borrower is unemployed and will receive documented unemployment benefits

VI. Delinquency is not over three payments or borrower is current with reasonably foreseeable default

ii. Terms:

I. UP forbearance period is up to 12 months or when the borrower becomes re-employed, whichever comes first

II. Payment must be reduced to 31% of borrower's gross monthly income and may be suspended in full at servicer's discretion

III. Servicer cannot initiate foreclosure action or conduct foreclosure sale

iii. Incentives – there are no extra incentives to the borrower or the servicer under UP

g. FHA Special Forebearance

Very similar to UP, FHA Special Forbearance applies to unemployed homeowners for up to 12-months under FHA-insured loans.

h. HAFA – Home Affordable Foreclosure Alternatives

HAFA allows homeowners to transition out of their mortgages through either a short sale or a Deed-in-Lieu ("DIL") of foreclosure and receive help with relocation to more affordable housing. HAFA has a less negative effect on credit scores than foreclosures and releases the borrower from the mortgage fully, rather than leaving the borrower responsible for the amount still owed.

This program is available to HAMP-eligible borrowers under the same criteria (and who have not purchased a home within 12 months) but who do not qualify for Trial Period Plan under HAMP, do not successfully complete a Trial Period Plan, miss at least two consecutive payments during a HAMP modification, or request a short sale or DIL. The plan provides $10,000 in relocation assistance.

i. Servicer Incentives:

    I. For every short sale or DIL completed under HAFA, the servicer receives $1,500 to cover administrative and processing expenses

ii. Investor Incentives:

    I. The investor may receive a maximum of $5,000 if it distributes a portion of the proceeds of a short sale to inferior mortgage lien holders

i. Redemption

Redemption is not a true alternative to foreclosure – it's the period after a foreclosure sale when the borrower can still reclaim the home by paying the outstanding mortgage balance and any costs incurred during the process.

b. Submitting a Loan Modification Request

The first thing to do when a borrower wishes to request a loan modification is to help the borrower understand what likely outcomes are possible and determine the best outcomes as well as clearly delineate what outcomes will be of no help to the borrower in the long term.

When requesting a loan modification, contact the lender or servicer and ask about available workouts being offered to distressed homeowners, whether under various federal programs (if the lender participates in such programs) or granted by the lender itself.

Gather all pertinent documents from the borrower relating to the borrower's financial situation, such as pay stubs, W-2s, tax returns, receipts, etc. Have the borrower provide a budget for current expenses as well as a long-term budget that paints the borrower's future financial picture.

If the borrower's financial issue is short-term, a forbearance agreement may be preferable to an out-and-out loan modification, and this may be more palatable to a lender as well.

c. Handling Your Client's Case

The most important aspect of a loan workout is sustainability. A workout must be sustainable over the long term. A modification that only delays dire financial consequences for the client will not help them in the long run, so negotiating a loan modification requires working with the servicer and assessing the accuracy of the numbers provided by the homeowner to make sure that any program or modification will ultimately keep the homeowner out of foreclosure. If a loan modification plan will not be sustainable, servicers will generally be responsive to alternatives and a middle ground can be sought.

Assessing the numbers accurately is the key. Homeowners need to supply ample documentation such as pay stubs, a budget and any other documents relevant to the potential modification that the servicer requests. Getting these from the borrower to the lender in a timely fashion is important, as any missing or outdated documents will only bring the borrower's application to the bottom of the pile if the servicer has to wait.

It's also in the client's best interest to understand that expectations should be realistic. Most programs are designed to bring payments down to certain thresholds and this may be as much assistance as a borrower can receive in a modification, even if it does not ultimately relieve the borrower from the entire financial crisis. Loan modifications are not bailouts as much as they're helpful assistance.

Attorneys should counsel clients to cut back on spending and provide accurate budget figures and income. Loan modifications may be necessary, but the client may also have to endure some lifestyle modifications as well, and attorneys should be frank about the ways the client will need to revise spending habits and budgets.

d. Negotiating the Best Possible Loan Modification

It is in the lender's best interest, generally, to avoid foreclosure litigation and the associated costs, such as court costs, legal fees and Master Commissioner fees. Whether it's a residential or a commercial loan, a foreclosure usually leaves the lender with a loss that is hard to recover at best and fully discharged in bankruptcy at worst. Lenders will also want to bolster any eventual foreclosure actions by showing that every possible alternative was provided to the borrower, so there is an incentive for them to work with the borrower on alternative outcomes wherever possible.

When the lender presents an offer to a loan modification request, there are several traps the borrower should avoid. For instance, the lender may offer the option to pay penalties on past-due balances now or roll them into the balance, but the lender is in a position to drop these penalties altogether. The lender may also seek out additional legal protections that strengthen its claim. There are also ticking bombs that lenders can offer, such as balloon payments or adjustable interest rates. Lenders can also offer a combination of modifications, such as a "Deed in Lieu" along with a forbearance agreement to pay off any deficiency balance. Creditor's counsel should think "outside the box" and fun the best, but most sustainable, modification of the loan.

Forbearance Agreements – Structure and Important Provisions

Submitted by Emily Cowles

II. Forbearance Agreements – Structure and Important Provisions

a. Forbearance Agreement Overview and Variations

A forbearance agreement is akin to the parties putting obligations on pause for a short period of time, which gives the debtor time to cure defaults, restructure, or even exit the lending relationship. A well-constructed forbearance agreement will provide the obligations of the parties, any security, an acknowledgement that a party has defaulted on obligations, a payoff as of the agreement's effective date, and the terms and conditions by which the lender agrees to forbear an exercise of its rights against the borrower. These terms and conditions can be tailored to any situation, and they can include a host of different obligations, releases, waiters, and incorporate additional collateral pledged to the lender. The agreement on the part of the lender to forbear is usually considered valid consideration for any new obligations or promises on the part of the borrower under such an agreement.

There are many terms, conditions and provisions that can be provided in a forbearance agreement, which should be drafted according to the unique set of facts presented in each case. An agreement should include, at a minimum:

i. Parties – the lender, the borrower and any other necessary parties, such as guarantors.
ii. Term – how long of a period the lender will agree to forbear.
iii. Payments – what the obligations of the borrower or any guarantor to make payments are.
iv. Default – what occurs in the event of a default by an obligor under the agreement, such as the agreement becoming null and void or the termination of the lender's obligation to forbear, thereby allowing the lender to proceed with enforcement.
v. Debt – an acknowledgement of the event of default and the debt due at the time of the execution of the agreement.

vi. Termination – similar to provisions concerning default of the borrower, events that trigger termination of the agreement should be listed, such as bankruptcy proceeding filed by or against the borrower. Parties may also wish to specify which triggering events lead to outcomes such as a foreclosure or bankruptcy filings.

vii. Fees and costs – any fees and costs that may be charged by the lender in consideration of the forbearance

b. Review of Existing Loan Documentation

It is of paramount importance to review all existing loan documentation ahead of entering a forbearance agreement. Such an agreement will usually re-ratify the terms of the existing loan, so creditor's counsel should familiarize themselves with the existing duties of the parties under the original loan and determine how the obligations shift or change temporarily or permanently under a forbearance agreement.

c. Debtor Provisions – What the Debtor Wants to Avoid

The negotiation process of the agreement will naturally be a give-and-take between the debtor and the creditor, and both sides will seek to include or exclude provisions favorable to one side or the other.

The borrower, for instance, will want a provision that the agreement will not breach any other agreement to which the borrower or guarantors are a party and that the agreement will not create or impose any further lien on the property at issue.

If the agreement contains a provision that renders the agreement null at the default of the borrower, the borrower may try to insert a clause granting a cure period for such default to keep the agreement in place and allow some breathing room. Such flexibility keeps the agreement in place in the event of unforeseen issues affecting the financial status of an already troubled borrower.

d. Creditor Provisions – What the Creditor Wants to Include

Possibly the lender's greatest fear is that any modification or forbearance may be deemed a novation. A novation, in essence, is a substitution whereby an original obligation is discharged and replaced with a new one. The end result of a novation is that any lien priority given to the original debt is erased, and the "new" debt becomes inferior to any intervening liens. It is crucial for the creditor to include a provision stating the agreement is a forbearance of existing credit and does not constitute a novation.

The creditor may also want affirmative covenants of the buyer, such as a covenant to exercise best efforts to sell collateral in partial satisfaction of amounts owed or a covenant to inform the lender of a change in financial circumstances.

The creditor should require that the borrower provide a financial statement prior to the effective date of the agreement and at regular intervals during the agreement in addition to any covenants informing the lender of a change in financial status. These statements would keep the lender up to date on the ability of the debtor to repay the loan under the forbearance agreement and forecast the future financial ability of the debtor to continue payment on the mortgage after the end of the agreement. Creditors would also want to include a statement that it is relying on the financial statements to judge the ongoing progress of the parties under the agreement, so any inaccuracy or omission in the financial statements upon which the creditor relies will render the forbearance agreement null and void.

The creditor should also seek a provision noting that the lender does not agree to waive any of the lender's rights under the underlying loan, and that all existing loan documents remain valid and enforceable.

The creditor should execute a release along with or as part of the forbearance agreement or loan modification that concerns any claims the debtor may have against the creditor. This agreement should have several provisions that further delineate the conduct of the parties and the specifics of the agreement:

i. Recitals – these are standard to any contract and should list the general terms of the agreement and provide a sense of what the parties are agreeing to in prose form.

ii. Confidentiality – the agreement should include a statement that both parties will keep the contents of the agreement confidential except as to necessary parties or others named in the provision.

iii. Additional Documents – this provision provides that each party will agree to execute and deliver any further documents or instruments necessary to effectuate the overall agreement.

iv. Borrower and Guarantors Release – this is the most important provision for creditors to include in any agreement. This provision requires the debtor to release any and all claims against the creditor as consideration for the agreement itself. This is an acknowledgment that the creditor is providing something of value to the debtor that it is not obligated to do, and the debtor cannot then sue the creditor as a result. The wording of this release should be as comprehensive as possible for creditors, encompassing any and all claims that could be brought by the debtor.

v. Representations and Warranties as to Subject Property: these provisions are also important, as they clarify the understanding of the parties as to the subject property. This section should include stipulations that the borrower actually holds title to the property pledged as security under the agreement, that there are no unrecorded option or purchase contracts, that there aren't any pending disputes (boundaries, legal claims or litigation) involving the property or tenants with any interests in the property, etc.

vi. Relationship of the Parties: clearly delineate the relationship between the parties as debtor and creditor, and leave no room for possible interpretation that the creditor owes fiduciary duties toward the debtor. The creditor is not a fiduciary, and a simple provision stating such will save multiple headaches.

vii. Lender's Remedies upon Default: set out the rights and remedies available to the lender at the event of default on the part of the buyer as broadly as possible, leaving no room for ambiguity as to what rights of the lender spring from a default.

viii. Other provisions: don't forget standard provisions such as the governing law of the agreement, whether time is of the essence, incorporation by reference, waiver of rights to a jury trial by all parties, a provision allowing for counterpart execution, jurisdiction and venue, a statement that the agreement constitutes the entire agreement of the parties, a provision stating that all amendments to the agreement must be in writing, and finally, the agreement should state that the failure of the lender to exercise a right or the course of dealing of the lender in respect to such a right does not constitute a waiver of that right, privilege, etc.

Lender Liability Issues

Submitted by Nick C. Thompson

Lender Liability

Lender Liability must always start with a detailed factual analysis of the debtor if a lawyer is to successfully litigate a lender liability action. Some lenders seem to never violate the rules for home mortgages. Kentucky Housing Corporation for instance normally goes to great lengths to insure the foreclosure is the only option left before the home is sent to a foreclosure attorney. Normally all options have been explored and offered to the homeowner before this lender sends a case to court. However when KHC sends the foreclosure package to the attorney the case is normally on the fast track to foreclosure.

Other lenders seem to habitually fail to follow the strict guidelines of Dodd Frank and the statutory and regulatory practices set forth for mortgage bankers licensed under ethical practice standards. After the glut of foreclosures caused by mortgage brokers and a few subprime and even a few prime lenders the lending practices and licensing has been tightened for the few bankers and companies that survived the recession. These guidelines are a shotgun approach by several agencies and inside practice standards to deal with the government, public and the industry loss of confidence in the mortgage system and home ownership. The old practices were so rampant with fraud, short term profit making and self-dealing that our mortgage system barely averted a total shutdown. Many practices and short cuts left lenders open to Lender Liability cases

The Basis for Lender Liability

The State of Kentucky has taken the position there is no initial or general presumption of a fiduciary duty for a lender to the borrower. However that initial or general presumption does not mean that the acts of a lender while the loan is being made or after it is made will not place the lender into the position of a trustee or fiduciary and impose upon the lender the liability for not living up to those duties. If the Lender contracts to provide services or products the contractual duty provides that service or product includes a standard of care. Contract theories normally provide a very limited recovery. But tort theories will often provide a much greater recovery allowing punitive damages, attorney fees and sometimes crushing damages to a company reputation.

The FDCPA allows a 1000 dollar minimum actual damages fee but it provides for attorney fees. The primary purpose of the FDCPA was to police the collection practices industry. It is not always important that the client has any injury. It is important that the lending or collecting industry maintains standards and lives by those standards. When a statute such as the FDCPA allows attorney fees even if the damages to the client are minor the attorney fees may be 6 or 7 figures. Graduates of Pete Barry's book camp rarely settle FDCPA cases for less than 100,000. His graduates file well pled and documented cases which they litigate to judgments knowing that litigation means the case may take years and appeal but it guarantees large attorney fees.

The lender may have a problem with contempt in bankruptcy court or it may have a problem under the unfair business practices statute. The purpose of Lender Liability is often to punish the lender. The purpose for the statute may or may not be to compensate the debtor.

The tone of Lender Liability litigation is to punish the lender. It is often best for the lender to admit the problem, create a cure so the problem will never repeat and to quickly settle . The litigation cost and cost from public exposure of the lenders unethical behavior will often far exceed the cost of settlement. Whether it is proven to be true or untrue, allegations of fraud and judicial contempt in an court you have to live in can be just as devastating as being prosecuted for pedophilia. The damage to revenue and business may cause the lender to close. Take the below hypothetical case where the facts, names of the parties, the lender and businesses have been changed. At least one of the parties was forced to eventually plead guilty in federal court to bank fraud. The general factual scenario comes from that investigation, the state court case, bankruptcy case(s) and convictions.

A Lender Liability Case Example

Tillys RVs had been in business for about 50 years. The owner had a heart attack and was forced to no longer actively run the RV dealership. The RV dealership depended on a bank to finance the units and when an RV was sold the bank was supposed to be paid immediately and it would release the title. The dealership had about 200 units. The dealer's son became the manager of the lot and became a drug addict. The president/owner of the bank had a daughter. Both the son and the daughter were married but they had an affair meeting secretly in a hotel 100 miles away. The RV's were not paid for and money from the RV's financed a drug habit and romance with the daughter. When questions about late payments for the sold units arose the daughter of the bank made a couple of the payments and shuffled paperwork to cover the theft of the funds. The sales, employee and other trust taxes went unpaid. Owners failed to get their titles.

The owner questioned the bank about the loan but was advised that the loan was up to date. Eventually the mortgage lender filed a foreclosure, the dealer financing problem surfaced and the dealership was forced to file bankruptcy. If this case came into your office with millions in damages where would you begin? It looks like a great Lender Liability case.

In law school we thought the questions were unrealistic. No one lives life that way. But war and law practice gives you cases stranger than anything the professor ever imagined.

Fair Debt Collection Practices Act

The Fair Debt Collection Practices Act only protects the debtor if the loan is **collected by a third party** for a **consumer debt**. If this case was based on the acts of a servicer any untrue, misleading or abusive behavior of the person attempting to collect the debt is subject to actual damages, punitive damages, and attorney fees. The untrue or misleading statement may be intentional or negligent. Nuisance phone calling can be stopped simply by requesting not to be called and to be placed on a do not call list. FDCPA does not just cover phone calls at unreasonable times but also phone calls to an employer if there is a reason to believe that the employer does not allow such calls. Most places of business do not allow personal calls and phone calls to places of employment should be presumed to be violations.

Conversations with third parties is very limited and generally limited to locating the borrower. If the communication is not to locate the borrower and is instead to harass his family and friends then the communication is a violation. Since this is a factual question for a trial of these facts, the issue should always survive a summary judgment and will often be resolved in favor of the debtor. If the debtor is represented by an attorney the communication must stop and collector that calls

FDCPA attorneys will often give out recording devices and no warning to the debt collector is required under Kentucky law that the debt collector is being recorded. There are apps for cell phones that will record all incoming calls which can be used. We often advise clients that their bankruptcy case may be free if they bring us a good case because the FDCPA case will often more than pay for the bankruptcy. A good FDCPA case is well worth the cost of a recorder. The Google and Apple app is free and even the attorney may have it on his phone recording all income calls from debt collectors. Debt collectors seem to have no end of abusive, misinformed or outright untrue communications.

Breeches of the Obligation of Good Faith and Fair Dealing

Oral agreements

Debtors always seem to come into the office with scenarios of he said she said. In the case of the RV dealer bank records showed the charges for the motel room the couple stayed at and the transfers into and from personal accounts. Oral versions of what each party simply does not stand up against recordings of the conversation, written contracts, what the parties actually did and other forms of hard proof. Oral agreements may be alleged and may become binding based on what the parties did. Every document should have a disclosure that the writing is complete and state there are no additional or separate agreements or promises.

Breach of Contract.

It is possible there may be a breach of contract when there is a loan modification is undertaken, the trial payments are tendered and accepted and then it is not converted into a permanent modification. In such cases an attorney may raise a defense that the lender breeched the promise to make the permanent modification if the borrower completed the process. A mediators report from the loan modification is an admissible document itself which in many states is a contract the mortgage company cannot repudiate. See First Franklin Financial v Gardner 60 A 3d 1262, 1263, 2013 ME 3. Normally this loan modification agreement document provides for a permanent modification upon completion of the trial term. Failing to complete the modification is a breach of this contract by the bank.

Good Faith and Fair Dealing

Almost every state has a statute which requires good faith and fair dealing in every contract. Although originally good faith and fair dealing was only in the Uniform Commercial Code covering the sale of goods it now has been expanded to contract from real property to services. This has often been expanded so far in some states it includes a fiduciary duty by the business to the consumer which is an even greater duty and liability. Good faith and fair dealing requires far more than just making sure there is no fraud. It requires an absence of underhanded tactics such as threatening the consumer or placing the consumer at risk. In a foreclosure action the offering of meaningful mediation by the lender may be a requirement of good faith.

Fraud and Negligent misrepresentation

Fraud is a breach of the obligation of good faith and fair dealing. It may be difficult to prove and it requires the Debtor pleads facts in detail but if the facts are pled in detail the claim of fraud is difficult to dismiss by summary judgment. Fraud rarely wins the case. But if it is proven such as in the RV dealership example it can win the day and can be the basis for a massive judgment against the lender.

Misrepresentation need not be intentional.   You can be a fool and be sued for negligent misrepresentation just as negligent drivers can be sued.   However in the negligent misrepresentation case a borrower must have been induced the debtor to act or not act. If the borrower simply did not make payments and fell behind then the bank did not induce the debtor to do anything.

Often clients will come into our office after they have read about an attorney in Florida that forged documents.   They know that they somehow have been defrauded. When you ask them for proof that their signature was forged or that the note was not properly transfer their faces turn blank. Most often the bank may have done some fraudulent thing. But the something was often the mistake was to give the client a loan and to cut corners in qualifying them for a mortgage just because they begged for it.

Bankruptcy Stay and Fraudulent Transfers

Street fights end up on the ground in a wrestling match and Foreclosures almost always end up in bankruptcy court for good reasons. The bank may sue and go after the deficiency. I know it is rare but it happens about 5% or less of the time.   With debt buyers now purchasing these debts I believe we can expect filing bankruptcy cases for years to come.

Almost all foreclosure cases should end with the homeowner filing bankruptcy. The lender is required by regulation to file a 1099-c. Unless the debtor files a bankruptcy to discharge the obligation the debtor will get a tax bill for the amount charged off by the bank plus penalties and interest. Filing a bankruptcy prior to the sale gives the debtor additional time in the home which he may need to find another home.   This is often a short period of time but it will usually give the debtor about 6 months during which he rarely pays mortgage payments. The failure to file a bankruptcy at the end of the foreclosure is at least a 20,000 dollar mistake and cost to the debtor in the average case. Short sales provide little or no benefit to the Debtor but when the debtor has a 30,000 dollar or more deficiency there will be at least a 10,000 dollar tax debt. Add to that the benefits of 1500 per month of free rent by not having to make payments for 6 months while the foreclosure is delayed and the debtor earns 20,000 tax free easily by filing bankruptcy just before the sale.

Once the bankruptcy case is filed the temporary court order called a stay goes into effect immediately whether or not the lender or collector has notice. It is easy to technically violate the stay.   However if the debtor can prove that it was intentionally or negligently violated the debtor will collect actual damages, punitive damages and attorney fees. These damages normally require the debtor to file an adversary proceeding to collect. These adversary proceedings are separate trials/cases in bankruptcy court which will sit as a federal district court. A violation of the stay will often bring numerous other charges such as FDCPA or other violations.

If the creditor transferred or received property without giving reasonable value back before the bankruptcy case is filed he may have committed a fraudulent transfer. Neither contempt nor fraudulent transfers require actual intent. Violating the temporary stay court order, the permanent discharge court order or a fraudulent transfer can be negligent as intentional. The statute states that anyone listed in the petition is presumed to know of the filing and the stay.

Mediation v Trial

The Lender who is counter sued or sued in state court will often want to force the case into mediation. This limits media exposure, litigation expense and often gives lower damages to the debtor. If the case is in bankruptcy court and filed as a contempt action or an adversary, mediation is unlikely. In bankruptcy contempt actions a judge will be the person who decides if contempt of the court or fraudulent transfer occurred.

The rules of evidence and court procedures in federal court are often very detailed and generate much larger attorney fees than state court. If the Debtor is successful in bankruptcy court normally all of these fees will become costs the lender will have to pay. If the lender is guilty, it is in a trap. The more the lender struggles against the Chinese finger trap the more the monetary damages it will have to pay to the debtor. If the case goes to mediation/arbitration in state court, the rule of an arbitrator/mediator in state court is not subject to review by the Circuit court and is final. Often it involves practically just as much work in preparation of the evidence before the arbitrator.

Foreclosure Statutes

There are steps the attorney must take in the foreclosure process and failing to join a party or to follow a local rule may cause the case to be dismissed and to be refiled. The individual rules and procedures are found in different sections of the codes and rules and it makes it helpful to have a checklist in filing or defending a foreclosure. Each individual step must be taken and most commissioners will not allow the bank's attorney to shorten the process.

Although lenders normally have no duty to the borrower regulations state that the banker has a fiduciary duty to the mortgage applicant. The statutory duties can often become a basis for making it a duty the employers duties and failure to supervise. The strategy of how you practice the case is like a chess game where plays should not be made too soon or too late. It is a seamless web we weave where everything is connected in a concert where it is not just a sound by a blowing of the wind with a certain scent with many elements which work together producing a single call to action by the judge left with no other logical choice.

Unfortunately the RV dealer didn't want to sue the bank because it might cause his son's divorce. The bank president had the same thought about suing the RV dealer for any deficiency. And we do work for our clients.

The Foreclosure Process

Submitted by James K. Murphy

I. Foreclosure Process

A. Considering the Necessity and the Advisability of Foreclosure

1. Marketability of the property: Foreclosure may be necessary to clear up the title to the property due to liens and other issues. Alternatively, foreclosure may stigmatize the property and make it more difficult to sell or lease.

2. Foreclosure may bring to light defenses to the foreclosure and potential counterclaims

3. Possibility of delays from jury trial being requested and other delays in foreclosure proceeding

4. Loss of equity to the borrower by forcing a foreclosure

5. Initiation of a foreclosure may permit immediate protection of property and rents by the appointment of a receiver

6. Potential cancellation of Insurance upon filing of foreclosure

7. Foreclosure will permit the lender to establish a deficiency balance, including attorney fees

8. Foreclosure may cause a borrower to file bankruptcy and enable the trustee to attack the validity of the mortgage lien, assignment of rents, and other documents/transactions with the borrower

9. Possibility of successful short sale, work out, or deed-in-lieu benefitting all parties

B. Curing Problems Before Filing the Action

1. Conduct a complete review of the loan file to identify any problems, defenses and possible counterclaims

2. Determine the existence of any representations by lender to borrower-verbal, written-regarding renewal and other concessions

3. Confirm that the documents are executed by the parties, and that mortgage, security agreement and any assignment are properly recorded

4. Possession of the Original Note

5. Proper legal description has been used in the documents

6. Existence of default

7. Notice of default given

8. Right to accelerate or waiver of acceleration

9. Title search at this stage is an opportunity to correct title issues before they are raised in litigation

10. Identify parties with potential interest through the title search.

11. Identify any new spouses

12. Easements subsequent to the mortgage will be identified in this title search and may be foreclosed off the property

13. Conduct a property inspection to determine parties in possession and condition of the property. The lender or buyer at the sale is not entitled to possession until after the sale is confirmed

14. Obtain confirmation that insurance is in force and will not be affected by the foreclosure

15. Determine the divisibility of the property as required by KRS 426.685

C. Commencing the Action

1. Every county has its own local rules and these should be consulted to avoid unnecessary delays in all aspects of foreclosure

2. Ensure compliance with the Fair Debt Collection Act by giving appropriate warnings

3. The complaint should:

    a. Include all proper parties

    b. State the correct legal description

    c. Allege basis of claim including default

    d. Allege indivisibility of property per KRS 426.685

    e. Ask for attorney fees and include statement that the attorney is not a salaried employee of the lender

    f. Attach all exhibits

g. Be verified with the client

4. Update the title immediately prior to filing the Complaint to insure all lien holders are included because it is easier to change the complaint before than after filing.

5. Ask for attorney fees and include statement that the attorney is not a salaried employee of the lender

6. File the complaint, obtain issuance of summons and begin service of process on all defendants.

7. Lis Pendens. The Lis Pendens Notice must be drafted to meet the statutory requirements of KRS 382.440 and should be filed immediately after the complaint. Update the title after the lis pendens is filed to completely verify the absence of intervening lie ns.

   A proper lis pendens will eliminate the need to join subsequent liens.

8. Serve Unknown Defendants by Warning Order Attorney per CR 4.05

9. Obtain Service of Process on out-of-state defendants by KRS 454.210

10. Service of Process on the United States Government per 28 USC 2410—note that the USA has 60 days to answer.

D. Obtaining Judgment

1. File a motion for default judgment or summary judgment depending upon the filing of an answer or other issues

2. The judgment should specify all of the basic elements of the case. A sample judgment appears at the end of the outline.

3. The judgment should be made final and appealable

4. The judgment must contain a master commissioner referral and a requirement of advertisement per KRS 424.120 and KRS 426.560

5. The judgment should provide that an appraisal of the property is to be made. KRS 426.520

E. Foreclosure sale

1. Foreclosure sales must be public, for cash, or upon reasonable terms as set by the court. KRS 426.700

2. Right of Redemption—one year. KRS 426.530

3. IRS has a right of Redemption for 120 days and the United Sates has a one-year right of redemption on other federal liens

4. The lender will typically bid the property in at two-thirds to eliminate the one-year right of redemption.

5. Prior to bidding at a sale, potential third-party buyers should contact the master commissioner to ensure that they will be qualified bidders and that the terms of the sale are acceptable.

6. KRS 426.705 requires the successful bidder to post a bond for the balance of the purchase with surety approved by the master commissioner.

7. Clients who are potential bidders should be thoroughly counseled as to the risks of purchasing at a master commissioner sale including (i) the necessity of obtaining property casualty insurance contemporaneously with the acceptance of the final bid and (ii) having ten days to object to the sale based solely upon defects in the title, not the discovery of mold or radon in the basement.

F. Confirmation of sale and disbursements.

1. In the event no objections to the sale are filed, the sale may be confirmed and the sale proceeds distributed upon the filing of a motion to confirm the sale ten days after the report of sale. CR 53.06and KRS 426.571.

2. Confirmation establishes a purchaser's right to possession and rents. KRS 426.571

G. A sample judgment and order of sale is set forth as follows:

NO. ____________________ **______________ CIRCUIT COURT**
DIVISION _________

______________, LLC **PLAINTIFF**
4

v.

FORECLOSURE COMPLAINT

DEFENDANTS

____
200 ______________ Street
______________, KY 40403

____
200 ______________ Street
______________, KY 40403

______________ COUNTY, KENTUCKY

Serve: County Attorney
______________ County, Kentucky

CITY OF __________

US BANK, N.A. A/K/A US BANK HOME MORTGAGE
425 Walnut Street
Cincinnati. Ohio 45202

Serve: **Kentucky Secretary of State**
Office of the Secretary of State
The Capitol Building
700 Capital Avenue, Suite 152
Frankfort, KY 40601

CAPITAL ONE BANK (USA), N.A.
11013 West Broad Street
Glen Allen, VA 23060

Serve: **Kentucky Secretary of State**
Office of the Secretary of State
The Capitol Building
700 Capital Avenue, Suite 152
Frankfort, KY 40601

*** *** *** ***

Plaintiff, _____________ (ultimate successor in interest to Independent Realty Capital Corp., d/b/a Independent Mortgage), by counsel, for its cause of action against the Defendants states as follows:

1. That on or about October 27, 2000, Defendants, _______________ and _______________ (collectively "Defendant") executed and delivered a certain Promissory Note in the original principal amount of $50,000.00 (the "Note"). **See EXHIBITA.**

2. At the same time, Defendant executed and delivered a Mortgage of even date with the Note in the original principal amount of $50,000.00 of record in Mortgage Book 632, Page 804 in the Office of the Clerk of _______________ County, Kentucky (the "Mortgage"). Said Mortgage was assigned to The Chase Manhattan Bank as Indenture Trustee, by assignment dated November 16, 2000, and recorded on March 14, 2003, in Mortgage Book M812, Page 299. See **EXHIBIT B.**

3. Plaintiff is the owner/holder of the Note and Mortgage.

4. The Note is presently in default in that there has been no payment made under the Note since October 27, 2000. Demand has duly been made on Plaintiff. See **EXHIBIT C.**

5. Plaintiff now declares the full amount due under said Note and Mortgage to be now due.

6. The property is more particularly described on **EXHIBIT D** attached hereto and incorporated herein by reference (the "Property").

7. There is now due and payable to Plaintiff the approximate sum plus interest of 419,643.71 since July 1, 2007 at the interest rate described and adjusted as set forth in the Note. The estimated amount of interest as of the date of this Complaint.

8. Plaintiff states that the Defendant, US Bank, N.A. successor in interest to First Federal Savings of Richmond, may claim an interest in the subject property by virtue of a Mortgage filed of record in Mortgage Book 404, Page 349 in the Office of the Clerk of ______________ County, Kentucky.

9. Plaintiff states that the Defendant, Capital One Bank, N.A., may claim an interest in the subject property by virtue of a Judgment Lien filed March 3, 2005, of record in Lis Pendens Book LP 56, Page 638 and LP 57, Page 41 in the Office of the Clerk of ______________ County, Kentucky.

10. Plaintiff has referred this claim to counsel who are not its regular salaried employees in pursuant to KRS 411.195 is entitled to recover its reasonable attorneys fees.

WHEREFORE, Plaintiff demands as follows:

1. A Judgment against the Defendants, ______________ and ______________, in the amount of $______________ plus interest, costs, expenses and attorneys fees.

2. That Plaintiff's Mortgage be determined to be a valid lien on the property and that each of the other Defendants be required to set up their liens or interests in the Property or forever be barred from asserting the same;

3. That said Property be ordered sold free and clear of all liens, claims and encumbrances and Plaintiff be paid out of the proceeds of such judicial sale;

4. For his costs herein expended, including his reasonable attorneys fees; and

5. For any and all other relief to which Plaintiff may appear entitled.

Respectfully submitted,

James K. Murphy
LYNCH, COX, GILMAN & GOODMAN, P.S.C.
500 W. Market Street, Suite 2100
Louisville, Kentucky 40202
(502) 589-4215
(502) 589-4994 Fax
Counsel for Plaintiff,

H:\JMurphy\PPR\Reed 110483\foreclosure complaint.doc

NO. 11-CI-256

_______________ CIRCUIT COURT
DIVISION II

PLAINTIFF

____

v.

MOTION FOR SUMMARY JUDGMENT

DEFENDANTS

____

*** *** *** ***

Plaintiff, ______________________________., and for its Motion for Default Judgment pursuant to CR 56 on the ground that there is no genuine issue as to any material fact and that this Plaintiff is entitled to judgment as a matter of law pursuant to Steelvest Inc. v. Scansteel Service Ctr. Inc., Ky., 807 S.W.2d 476 (1991). A Memorandum in Support of this Motion is attached hereto and made a part hereof.

Pursuant to ______________ County Local Rule 6.01, this Motion is submitted for judgment with a copy to the Clerk so that it may be efficiently addressed by the Court.

Respectfully submitted,

____

James K. Murphy
LYNCH, COX, GILMAN & GOODMAN, P.S.C.
500 W. Jefferson Street, Suite 2100
Louisville, Kentucky 40202
502-589-4215
502-589-4994 Fax
Counsel for Plaintiff

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing was on this _____ day of _______________, 2012 sent via U.S. Mail, postage prepaid to the following:

____
James K. Murphy

NO. 11-CI-256

______________ CIRCUIT COURT
DIVISION II

PLAINTIFF

____

v.

<u>MEMORANDUM IN SUPPORT OF</u>
<u>MOTION FOR SUMMARY JUDGMENT FACTUAL BACKGROUND</u>

__________________, et al

DEFENDANTS

*** *** *** ***

FACTUAL STATEMENTS

On July 15, 2010, Plaintiff filed its Complaint against Defendants, ____________________, seeking a judgment against Defendant following Defendant's default on the Notre and Mortgage in (the "Debt", representing principal balance plus interest and expenses), as described in the Complaint.

Ultimately, Defendant, ________________ was served and filed an Answer. Other than asserting the usual affirmative defenses, Defendants, Sam Reed et al, do not assert any defense to payment of this debt. As a result, this is a simple case of non-payment under a Mortgage Note and a judgment and order of sale is warranted at this time.

ARGUMENT

I. **<u>Summary Judgment is warranted at this time as there is no issue of Material Fact</u>.**

CR 56.01 states as follows:

3

A party seeking to recover upon a claim, counterclaim, or cross-claim ... may, at any time after the expiration of 20 days from the commencement of the action ... move with or without supporting affidavits for a summary judgment in his favor upon all or any part thereof.

Under CR 56.03, a motion for summary judgment should be granted when "there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." The presence of non-material factual issues does not alter this result. Isaacs v. Smith, Ky., 5 S.W.3d 500, 503 (1999); see also Rone v. Daviess County Board of Education, Ky. App., 655 S.W.2d 28, 29 (1983).

In Steelvest v. Scansteel Service Center, Ky., 807 S.W.2d 476, 480 & 483 (1991) citing Paintsville Hospital v. Rose, Ky., 683 S.W. 255 (1985), the Supreme Court of Kentucky held that the determination of whether there was a "genuine issue" of material fact had to be determined by analyzing whether it would be "impossible for the respondent to produce evidence at the trial warranting a judgment in his favor." Many courts interpreted his holding to require that, even where no material fact issue had been raised by the evidence presently before it, courts were nonetheless required to look at whether it would be theoretically possible for such an issue to be raised at trial.

The Supreme Court of Kentucky has now explained that Steelvest was never intended to go so far. Too much attention was given to the word "impossible," the Court said. Welch v. American Publishing Co. of Kentucky, Ky., 3 S.W.3d 724, 729 (1999). All that word was intended to imply was that reviewing courts should "refrain from weighing evidence at the summary judgment stage." Id. at 729-30. The proper inquiry is:

> Whether, from the evidence of record, facts exist which would make it possible for the non-moving party to prevail. In the analysis, the focus should be on what is of record rather than what might be presented at trial.

Id. At 730. (Emphasis added).

So, the proponent of a summary judgment motion does not need to show that it would be theoretically impossible for the opponent to raise a material issue at trial, but rather that the opponent has not shown sufficient evidence through discovery to make it possible for him to succeed at trial.

In Steelvest at 482, the court added that a party opposing a properly supported summary judgment motion cannot defeat it without presenting at least some affirmative evidence showing that there is a genuine issue of material fact for trial.

As even the Court in Steelvest realized, summary judgments serve a valuable purpose; they exist to "expedite the disposition of cases and to avoid unnecessary trials where no genuine issues of material fact are raised." Steelvest at 482; see also Young v. White, Ky. App., 551 S.W.2d 12, 14 (1977); 7 Clay, Kentucky Practice, 218 (3d ed. 1974).

With the clarification in Welch, the Supreme Court of Kentucky has breathed new life into the purposes and value of summary judgments. Old rules, which were seemingly extinguished by Steelvest, are now, once again, viable.

Here, Summary Judgment, even under the older standard, is warranted as there is no material fact at issue. Each of the Defendants have admitted to the events of default under the loan documents and has failed to make arrangements to extinguish the Debt. (See Exhibit A which is the Deposition of Debra Reed, specifically, Page 8, lines 6 – 10; Page 9, lines 24-25, Page 10 and Exhibit B which is the Deposition of Sam Reed, specifically, Page 8 lines 12-20.) The Defendants have no defenses to the non-payment and therefore summary judgment is warranted at this time.

CONCLUSION

Accordingly, Plaintiff should, as a matter of law, be granted its motion for summary judgment and Plaintiff should be entitled to its judgment in the amount of $____________________ and Plaintiff should be allowed to exercise any and all of its rights thereunder.

Respectfully submitted,

____

James K. Murphy
LYNCH, COX, GILMAN & GOODMAN, P.S.C.
500 W. Jefferson Street, Suite 2100
Louisville, Kentucky 40202
502-589-4215
502-589-4994 Fax
Counsel for Plaintiff,

NO. 11-CI-256

____________ CIRCUIT COURT
DIVISION II

PLAINTIFF

____

v.

AFFIDAVIT

DEFENDANTS

____________, et al

*** *** *** ***

Comes now James K. Murphy, one of the Attorneys for the Plaintiff, and states as follows:

1. That your Affiant is one of the attorneys for the Plaintiff, ____________ in the within action, and makes this Affidavit in support of the Motion of ____________, for Default Judgment and Order of Sale wherein an attorney's fee, pursuant to KRS 411.95 is requested, and wherein the sum of said attorney's fee agreed to be paid by ____________ for the services that have been rendered and are to be rendered in this litigation amounts to $____________.00.

2. That Lynch, Cox, Gilman & Goodman, P.S.C., by whom your Affiant is employed, are not salaried employees of ____________ and thus are entitled to an attorney's fee pursuant to KRS 411.95 and the Note and Mortgage attached as Exhibit "A" and "B" to the Complaint.

3. That during the course of this litigation, your Affiant and others have expended in excess of forty (40) hours in the course of rendering services on behalf of the firm of Lynch, Cox, Gilman & Goodman, P.S.C. and as such is entitled to attorney's

fees as provided in KRS 411.95. Affiant further states that reasonable and customary charges for services of $__________.00 and that said services and charges were necessary and reasonable in connection with this litigation and such costs and charges are further itemized on the invoice attached to this Affidavit as Exhibit A.

4. Defendant's obligation to be responsible for said attorneys fees evidenced by Section 10 of that certain Mortgage, dated May 4, 2005 of record in Mortgage Book 9363, Page 139 in the Office of the Clerk of __________ County, Kentucky and as highlighted in Exhibit B attached hereto.

Affiant further sayeth naught.

____
James K. Murphy

COMMONWEALTH OF KENTUCKY)
)SS
COUNTY OF __________)

Subscribed and sworn to before me by James K. Murphy, Affiant, this _____ day of __________, 2012.

____
Notary Public, State-at-Large, Kentucky

Commission expires: ________________

NO. 11-CI-256

______________ CIRCUIT COURT
DIVISION II

______________, LLC

PLAINTIFF

v.

MILITARY AFFIDAVIT

______________, et al

DEFENDANTS

*** *** *** ***

Affiant states that he is one of the Attorneys for the Plaintiff in this action and that during the pendency of this action the above named Defendant has and is not now in the active Military Service of the United States or any of its allies.

____
James K. Murphy

COMMONWEALTH OF KENTUCKY)
)SS
COUNTY OF ______________)

Subscribed and sworn to before me by James K. Murphy, Affiant, this ______ day of ______________, 2012.

____
Notary Public

Commission expires: ______________

9

NO. 11-CI-256

_____________ CIRCUIT COURT
DIVISION II

_____________, LLC

PLAINTIFF

v.

ORDER OF JUDGMENT AND SALE

DEFENDANTS

_____________, et al

*** *** *** ***

On Motion of the Plaintiff, by counsel, supported by Affidavit of ____________________.

IT IS HEREBY ORDERED, ADJUDGED AND DECREED by this Court:

1. That there is a balance due to the Plaintiff, ______________, under its Note and Mortgage herein, in the sum of $_____________, with interest thereon at the current rate of 12.75%, per annum from June 20, 2006, until entry of Judgment herein, plus accrued late charges, plus the costs of the Plaintiff herein expended. The Plaintiff shall also recover attorney's fees in this action, in the sum of $_____________.00.

2. To secure to the Plaintiff the above, the Plaintiff is adjudged a lien prior and superior to any and all other liens and encumbrances of the parties as established by the exhibits attached to the pleadings of record, except the following:

(a) Federal tax liens attached to the real estate;

10

(b) Unpaid State and County taxes and unpaid City taxes and all taxes hereafter for which the purchaser shall not receive credit against the purchase price;

(c) Restrictions, stipulations and easements of record;

(d) Any assessment for public improvement levied against said property;

(e Any encroachments and overlaps, and any other matters which an accurate survey or an inspection of the premises would disclose; and

(f) Zoning regulations; and

(g The lien of ________________.

Upon the following described real estate, with improvements thereon situated and appurtenances thereunto belonging, the rents, issues and profits thereof, situated in ______________ County, Kentucky:

3. The above-mentioned real estate is indivisible and cannot be divided without materially impairing its value or the value of the Plaintiff's lien thereon.

4. The mortgage lien of the Plaintiff shall be enforced and to that end, the above-described property shall be sold. The purchaser shall take said real estate subject to those items set out in Paragraph 1, above and, but said real estate shall be sold free and clear of all other liens and encumbrances of the parties. However, the Plaintiff, the Court and the Commissioner shall not be deemed to have warranted title to any purchaser.

5. The Commissioner of the ______________ Circuit Court shall set the amount of any required deposit at Judicial Sale and ordered herein in a sum sufficient to cover the expenses of sale and/or resale, if necessary, per ______________ Circuit Court Rules

6. The proceeds of sale or a sufficiency thereof, shall be applied to the following items in this order of priority:

(a) to the cost of this action;

(b) to the full satisfaction of the liens in favor of the Plaintiff as set out in Paragraph 1 above;

(c) Any junior liens shall attach to the surplus proceeds of sale, if any, in the same priority in which they attached to the real property.

7. This is a final and appealable Judgment and Order of Sale; and there is no just reason for delay.

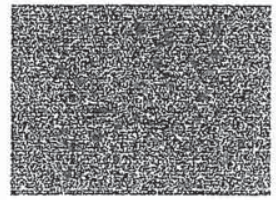
8. Pursuant to CR 77.04, the Clerk of this Court is directed to service notice of entry of this Default Judgment and Order of Sale in the manner provided by CR 5 upon every party who is not in default for failure to appear. The Circuit Clerk shall make a note in the Civil Docket of the service required by CR 77.04(1) and the notation shall show the date of service.

This action is retained for such further orders and proceedings as may be necessary, including future attorney's fees.

____

Judge, ____________ Circuit Court

Date: ________________________



GUIDELINES FOR LIEN ENFORCEMENT ACTIONS
IN JEFFERSON COUNTY, KENTUCKY.

PRODUCED BY

JEFFERSON CIRCUIT COURT COMMISSIONER

514 W. Liberty St., 4th Floor, Louisville, KY 40202
Phone (502) 574-5934 • Fax (502) 574-5741

Updated 8-05

Part V Short Sale Procedures

A. Short Sales

1. What is a Short Sale and When can it be Done?

A short sale is common term for a real estate transaction in which the purchase price of the property will be less than the total balance remaining on the outstanding mortgage. In such a situation, all lien holders must agree to take a lower amount than their outstanding liens in order for clear title to be granted to the purchaser.

2. Benefits of a Short Sale

There are many benefits to a short sale for all parties involved. The first mortgage holder, usually the bank, will receive a portion of the outstanding mortgage balance without having to go through the long process of formal foreclosure proceedings. The owner is able to walk away from the home without having to go through the foreclosure process and a possible judgment against the owner personally. The junior lien holders are able to receive some money in exchange for the release of their liens. If the property fell into a foreclosure proceeding, the junior lien holders' liens would be extinguished by the first mortgage holder.

3. Parties Involved

Short sales can involve a number of parties. The three main parties are: 1) the owner of the property; 2) the first mortgage holder, usually a bank; and 3) junior lien holders. Without all the lien holders agreeing to take less than they are owed, the short sale process will end. The first mortgage holder usually will be the lien holder driving the transaction since its lien is usually the largest dollar amount. In addition, the first lien typically is the lien upon which the owner has fallen behind on his or her payments.

Other potential parties can include: 1) attorneys; 2) real estate agent and brokers; 4) appraisers; and 5) a title company. Due to the complexity of the transaction, the owner will typically have an attorney representing his or her interest in the short sale process. If the bank has already begun a foreclosure proceeding, the bank may also have an outside attorney involved. Further, the junior lien holders, such as a homeowners association, may engage an attorney to represent their interests in the pending short sale.

Real estate agents, brokers and appraisers are often involved as well. There are many real estate agents and brokers that specialize in short sales. Due to the documentation involved in the process, it might be beneficial to engage the services of an agent or broker familiar with the process. The bank may have an internal appraisal department or use an outside company. Appraisals are necessary to show that the market value of the home is indeed lower than the outstanding mortgage balance. Finally, a title company is involved to handle the closing and issue title insurance.

4. Navigating the Process

The short sale process begins when an owner decides to sell his or her home, but the value of the property is lower than the outstanding balance remaining on the mortgage. The short sale process can take a long time to complete due to the document review needed in order for an approval to be obtained. The owner should make any potential purchaser aware that the sale will be a short sale by disclosing such information to the purchaser and using a short sale rider on the sales contract.

The first thing the owner should do is contact his or her bank to determine what documents will be needed to review a potential short sale. Every bank has its own standards to follow and documents to submit. Examples of typical documents are discussed in the following section. An owner should not start the pre-approval process too early or the bank may require updated documents. Therefore, an owner may be better off waiting until there is an offer on the property before submitting everything. Once the owner knows what documents will be required, the owner can list the property for sale as a short sale. The owner should be aware that a short sale may limit the number of potential purchasers for the property since some purchasers may not be willing to wait the extended time period involved in a short sale.

Once an offer is made, the owner should submit the offer to the bank for review, along with any other required documents. Pursuant to Section 1401.1 of the Illinois Mortgage Foreclosure Law, the bank must respond to the owner within 90 days after receipt of the written offer by the bank. 735 ILCS 5/15-1401.1. The owner must make sure that all the provided documents are complete. Missing or incomplete documents could result in further delays in the approval of the sale. The approval of any junior lien holders must also be obtained at this time.

If the sale is approved, the bank will provide a release of the mortgage to the title company at closing. The bank may also require the owner to sign a new note for the remaining outstanding balance on the mortgage since the owner is still liable for the difference in the mortgage balance and the funds received by the bank at closing. If the bank is waiving any deficiency, the owner's attorney should make sure that an agreement is signed by the bank and owner stating such.

5. Short Sale Request/Short Sale Package – Review of Documents Included

In order to proceed with a short sale, the owner will be required to seek approval from the bank. While every bank will have different specific requirements for the owner, generally speaking many of the same documents will be required. Many banks have a standard checklist of documents for any type of loss mitigation, such as a short sale, deed-in-lieu or consent foreclosure. The following is a typical pre-approval documents checklist for a short sale from a bank's loss mitigation department:

If Employed:

- Hardship Letter

- Financial Worksheet provided by the bank
- Two most recent bank statements, checking and/or savings, including documenting the source of all deposits
- Proof of Income: Most recent month's pay stubs or copy of award letter if collecting Social Security
- Rental agreement if you have rental income from the property
- Copy of W2 from prior year, if available
- Copy of signed and dated full tax returns from previous year, including the signed 4506-T form
- Copy of current homeowner's insurance declaration page
- Proof of flood insurance, if applicable
- Signed third party authorization, if applicable

If Self-Employed:

- Hardship Letter
- Financial worksheet provided by the bank
- Six most recent bank statements, checking and/or savings, personal and business, including documenting the source of all deposits on personal bank statements
- Rental agreement if you have rental income from the property
- Copy of signed and dated personal and business full tax returns from previous year, including the signed 4506-T form; S-Corps, C-Corps and Partnerships will need business tax returns and K-1's, if applicable
- Copy of current homeowner's insurance declaration page
- Proof of Assets – Investments
- Minimum of 6 months Profit and Loss statement, signed and dated with a time frame to coincide with the provided bank statements
- Proof of flood insurance, if applicable
- Signed third party authorization, if applicable

When proceeding with a short sale, the bank will require additional information and documents specific to the offer. The following is a typical short sale checklist:

- Signed Offer to Purchase
- Listing Agreement
- Estimated Settlement Statement/HUD
- Title, if available
- Buyer's Appraisal
- First Mortgage Payoff Statement
- Proof of Funds

Banks will break down the required documents by employed and self-employed because each type of employment will produce different documents. If an owner is unemployed, he or she should submit the documents associated with the owner's previous type of employment. Many of the documents will be the same for both types of employment history, with the exception of tax forms and bank statements.

One of the most important items for the owner to produce is the hardship letter. This is the owner's opportunity to explain to the bank his or her situation and why he or she needs to complete a short sale. Since banks will review each short sale individually, the owner will want to specifically explain his or her hardship. The more detail an owner provides will help the bank make its decision in a timely manner. The owner should be honest in the hardship letter because the bank may investigate the information contained therein.

Further, the financial statement will allow the bank to evaluate the owner's financial status. The specific information required in the financial statement will vary from bank to bank. The bank should have a form financial statement for the owner to fill out as part of its loss mitigation package. Typically, the owner must provide general information, such as name, address, social security number and employment information for the borrower and co-borrower. Additionally, the owner must provide income information, such as employment income, social security benefits, and rental income. Further, the owner must provide a list of monthly expenses, such as other mortgage payments, homeowner's insurance, real estate taxes, food, cable, telephone, child care, auto loans, auto insurance, and credit card payments. Finally, the owner will need to provide a list of his or her assets and liabilities, such as primary home, other real estate, cars, boats, cash, checking accounts, savings accounts, stocks, IRAs, bonds, and 401(k)/pension funds. Banks will verify the information provided, so owners should be careful to accurately provide all the required information.

Additionally, the bank will review the offer to purchase and the listing agreement to ensure that there is nothing strange regarding the transaction. Banks will require that the transaction be an arm's length transaction. If the bank is agreeing to take less money than it is owed, it will make sure that the owner is not going to benefit in some way at its expense. In addition, many banks will limit the real estate agent's commission to a certain percentage since all the parties are taking less money on the deal. A review of the listing agreement will help determine if there will be a problem before the parties get to closing. The estimated settlement statement/HUD will be reviewed by the bank to ensure that the owner is not receiving any money back in the sale. It does not want to see any hidden credits somewhere on the statement. Finally, the buyer's appraisal will be compared with the bank's appraisal of the property. This will confirm the fair market value of the property.

Owners should be aware that the bank may require additional documents based upon the specifics of the transaction. As such, the owner should be ready to provide any additional documentation upon request to help move the transaction along. Any delay could impact whether the potential purchaser walks away from the deal. Finally, each short sale offer provided to the bank will be different as well. While the owner may only need to provide the items on the pre-approval checklist once, the owner should be ready to provide the items on the short sale checklist for each offer.

6. Implications of Short Sale

Short sales can lead to many issues. While the owner may be able to walk away from the mortgage payments on the home, he or she may still be liable to the bank for any deficiency. The bank may require the owner to sign a new note and agree to pay the outstanding balance personally since it no longer has a secured interest in the property. Additionally, if the bank forgives the deficiency, the owner will be responsible for paying taxes on the amount forgiven. The amount is considered income to the owner under the Federal Tax Code. Exceptions to income from forgiveness of a debt occur from time to time. Therefore, the owner should discuss the tax impact with his or her attorney and tax professional.

Short Sales Procedures

Submitted by James K. Murphy

BENEFITS OF A SHORT SALE

1) An opportunity to seek and obtain debt forgiveness. Generally, three opportunities to obtain debt forgiveness may present themselves, but you only need one:

a) Short Sale Approval Letter;

b) Consent Judgment (through litigation); and

c) Foreclosure Auction if LENDER/PLAINTIFF bids full amount of debt (leaving no deficiency balance).

2) Upon achieving debt forgiveness, LENDER/PLAINTIFF will issue, in January of the following year, a 1099-C (Cancellation of Debt). Although this creates taxable income, there are three exceptions to income taxation which may apply (IRS Form 982):

a) Bankruptcy;

b) Insolvency (negative net worth); and/or

c) Mortgage Debt Forgiveness Act of 2007. The requirements of this Act, if extended beyond 12/31/2014 are:

1) Property was MORTGAGOR'S principle residence for 2 of the last 5 years

AND

2) The proceeds from the loan were used to purchase the property OR Refinance to change rate and term and without taking cash out OR Refinance with cash out, but most went into capital improvements in the subject property

3) Generally, there is an opportunity to reinstate credit worthiness in 3 years following the short sale (vs. 7 years after an auction).

4) Emotionally, MORTGAGORS may feel better about the sale of their home to eager and caring buyers as opposed to seeing the property go to the LENDER.

5) Relocation/Incentive money may be available at closing to MORTGAGORS (ranging from $1,500 to $26,000).

A. Short Sales

1. What is a Short Sale and When can it be Done?

A short sale is common term for a real estate transaction in which the purchase price of the property will be less than the total balance remaining on the outstanding mortgage. In such a situation, all lien holders must agree to take a lower amount than their outstanding liens in order for clear title to be granted to the purchaser.

2. Benefits of a Short Sale

There are many benefits to a short sale for all parties involved. The first mortgage holder, usually the bank, will receive a portion of the outstanding mortgage balance without having to go through the long process of formal foreclosure proceedings. The owner is able to walk away from the home without having to go through the foreclosure process and a possible judgment against the owner personally. The junior lien holders are able to receive some money in exchange for the release of their liens. If the property fell into a foreclosure proceeding, the junior lien holders' liens would be extinguished by the first mortgage holder.

3. Parties Involved

Short sales can involve a number of parties. The three main parties are: 1) the owner of the property; 2) the first mortgage holder, usually a bank; and 3) junior lien holders. Without all the lien holders agreeing to take less than they are owed, the short sale process will end. The first mortgage holder usually will be the lien holder driving the transaction since its lien is usually the largest dollar amount. In addition, the first lien typically is the lien upon which the owner has fallen behind on his or her payments.

Other potential parties can include: 1) attorneys; 2) real estate agent and brokers; 4) appraisers; and 5) a title company. Due to the complexity of the transaction, the owner will typically have an attorney representing his or her interest in the short sale process. If the bank has already begun a foreclosure proceeding, the bank may also have an outside attorney involved. Further, the junior lien holders, such as a homeowners association, may engage an attorney to represent their interests in the pending short sale.

Real estate agents, brokers and appraisers are often involved as well. There are many real estate agents and brokers that specialize in short sales. Due to the documentation involved in the process, it might be beneficial to engage the services of an agent or broker familiar with the process. The bank may have an internal appraisal department or use an outside company. Appraisals are necessary to show that the market value of the home is indeed lower than the outstanding mortgage balance. Finally, a title company is involved to handle the closing and issue title insurance.

4. Navigating the Process

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Deeds-in-Lieu of Foreclosure

Submitted by James K. Murphy

The Deed in Lieu Process

The first step in obtaining a deed in lieu is for the homeowner to request a loss mitigation package from the loan servicer (the company you make your mortgage payments to). The application will need to be filled out and submitted along with documentation pertaining to the homeowner's income and expenses including:

- proof of income (generally two recent paystubs or, if the homeowner is self-employed, profit and loss statements);
- recent tax returns;
- a financial statement, detailing monthly income and expenses;
- bank statements (two recent statements for all accounts); and
- a hardship letter or hardship affidavit.

A hardship is a circumstance that is beyond the homeowner's control that results in the homeowner no longer being able to afford to make mortgage payments. Hardships that qualify for loss mitigation consideration include, for example, job loss, reduced income, death of a spouse, illness, medical expenses, divorce, adjustable mortgage loan interest rate reset, and a natural disaster. (Sometimes, the loan servicer requires the homeowner to attempt to sell his or her home for its fair market value before it will consider accepting a deed in lieu.)

Next, the loan servicer will order a title search. The bank will generally only accept a deed in lieu of foreclosure on a first mortgage, meaning there must be no additional liens, such as second mortgages, judgments from creditors, or tax liens exist on the property. An exception to this is if the same bank holds both the first and the second mortgage on the property. Alternatively, a borrower can choose to pay off any additional liens (such as a tax lien or judgment) to facilitate the deed in lieu transaction. If the loan is insured by the U.S. Department of Housing & Urban Development (HUD), HUD will cover up to $2,000 to pay off second liens when determining eligibility for a deed in lieu. If the title is clear, then the loan servicer will arrange for a brokers price opinion (BPO), which will determine the fair market value of the property.

Once the bank agrees to accept the deed in lieu, the homeowner will be required to sign a grant deed in lieu of foreclosure, which is the document that transfers ownership of the property to the bank, and an estoppel affidavit. The estoppel affidavit sets out the terms of the agreement between the bank and the homeowner and will include a provision that the homeowner acted freely and voluntarily, not under coercion or duress. It may also include provisions addressing whether the transaction is in full satisfaction of the debt or whether the bank has the right to seek a deficiency judgment.

Deficiency Judgments Following a Deed in Lieu of Foreclosure

A deed in lieu is generally considered to be in full satisfaction of the mortgage debt and, as such, there can be no action for a deficiency judgment since there is no deficiency. So, with most deeds in lieu, the bank can't obtain a deficiency judgment for the difference between the property's fair market value and the debt. However, if the bank wants to preserve its right to seek a deficiency judgment, in most jurisdictions the bank can do so by explicitly and clearly negotiating that a balance remains after the deed in lieu. The bank would need to specify the amount of the deficiency and include this amount in the deed in lieu documents or in a separate agreement.

Whether or not the bank can pursue a deficiency judgment following a deed in lieu is also dependent on state law. For example, Washington has explicit case law that states a loan holder may not obtain a deficiency judgment after a deed in lieu, even if the consideration is less than a full discharge of the debt. *Thompson v. Smith*, 58 Wn. App. 361 [1990]. The Washington court ruled that because the deed in lieu was effectively a nonjudicial foreclosure, the homeowner was entitled to protection under Washington's anti-deficiency laws. Additionally, certain states, such as California, have laws prohibiting a deficiency following a short sale, which could potentially be interpreted by courts as analogous to prohibiting a deficiency following a deed in lieu. Cal. Code Civ. Pro. § 580[e]. While the California statute does not technically apply to a deed in lieu, a court could potentially view this as evidence of a legislative intent to prohibit deficiency judgments following all loss mitigation transactions.

SHORT SALE VS. FORECLOSURE

Many homeowners facing foreclosure determine that they just can't afford to stay in their home. If the homeowner plans to give up your home but want to avoid foreclosure the homeowner might consider a short sale or a deed in lieu of foreclosure. These options allow the homeowner to sell or walk away from the home and may help avoid incurring liability for a "deficiency."

To learn about deficiencies, how short sales and deeds in lieu can help, and the advantages and disadvantages of each, read on.

Short Sale

In a "short sale" the homeowner gets permission from the lender to sell your house for an amount that will not cover your loan (the sale price falls "short" of the amount the homeowner owe sthe lender). In many states, lenders can sue homeowners even after the house is foreclosed on or sold, to recover any remaining deficiency. A deficiency occurs when the amount the homeowner owes on the home loan is *more* than the proceeds from the sale (or auction) -- the difference between these two amounts is the amount of the deficiency. If the homeowner lives in a state that allows lenders to sue for a deficiency, get your lender to agree (in writing) to let the homeowner off the hook.

How will a short sale help? The main benefit of a short sale is that the homeowner may be able to get out from under your mortgage without liability for the deficiency. In order for this to work, however, the homeowner must either live in a state that doesn't allow deficiencies after short sale or get the lender to agree to waive the deficiency. Some states don't allow a deficiency after a foreclosure, so in some situations the homeowner might be better off with a foreclosure rather than a short sale if the homeowner can't get your lender to waive the deficiency.

The homeowner also avoids having a foreclosure or a bankruptcy on your credit record. Keep in mind, however, that a short sale will damage your credit -- although it may cause less damage than a foreclosure or bankruptcy.

What are the drawbacks? You've got to have a bona fide offer from a buyer before the homeowner can find out whether or not the lender will go along with it. In a market where sales are hard to come by, this can be frustrating because the homeowner won't know in advance what the lender is willing to settle for.

What if the homeowner has more than one loan? If the homeowner has a second or third mortgage (or home equity loan or line of credit), those lenders must also agree to the short sale. Unfortunately, this is often impossible since those lenders won't stand to gain anything from the short sale.

Beware of tax consequences. A short sale may generate an unwelcome surprise: Taxable income based on the amount the sale proceeds are short of what the homeowner owe (again, called the "deficiency"). The IRS treats forgiven debt as taxable income, subject to regular income tax. The good news is that thanks to the Mortgage Forgiveness Debt Relief Act of 2007, there are some exceptions for the years 2007 to 2013.

Deed in Lieu of Foreclosure

With a deed in lieu of foreclosure, the homeowner gives their home to the lender (the "deed") in exchange for the lender canceling the loan. The lender promises not to initiate foreclosure proceedings, and to terminate any existing foreclosure proceedings. Be sure that the lender agrees, in writing, to forgive any deficiency (the amount of the loan that isn't covered by the sale proceeds) that remains after the house is sold.

Before the lender will accept a deed in lieu of foreclosure, it will probably require the homeowner to put your home on the market for a period of time (three months is typical). Banks would rather have the homeowner sell the house than have to sell it themselves.

Benefits to a deed in lieu. Many believe that a deed in lieu of foreclosure looks better on your credit report than does a foreclosure or bankruptcy. In addition, unlike in the short sale situation, the homeowner do not necessarily have to take responsibility for selling your house (the homeowner may end up simply handing over title and then letting the lender sell the house).

Disadvantages to a deed in lieu. There are several downfalls to a deed in lieu. As with short sales, the homeowner probably cannot get a deed in lieu if the homeowner have second or third mortgages, home equity loans, or tax liens against your property.

In addition, getting a lender to accept a deed in lieu of foreclosure is difficult these days. Many lenders want cash, not real estate -- especially if they own hundreds of other foreclosed properties. On the other hand, the bank might think it better to accept a deed in lieu rather than incur foreclosure expenses.

Beware of tax consequences. As with short sales, a deed in lieu may generate unwelcome taxable income based on the amount of your "forgiven debt."

If your lender agrees to a short sale or to accept a deed in lieu, the homeowner might have to pay income tax on any resulting deficiency. In the case of a short sale, the deficiency would be in cash and in the case of a deed in lieu, in equity.

Here is the IRS's theory on why the homeowner ows tax on the deficiency: When the homeowner first got the loan, the homeowner didn't owe taxes on it because the homeowner were obligated to pay the loan back (it was not a "gift"). However, when the homeowner didn't pay the loan back and the debt was forgiven, the amount that was forgiven became "income" on which the homeowner owe tax.

The IRS learns of the deficiency when the lender sends it an IRS Form 1099C, which reports the forgiven debt as income to you.

No tax liability for some loans secured by your primary home. In the past, homeowners using short sales or deeds in lieu were required to pay tax on the amount of the forgiven debt. However, the new Mortgage Forgiveness Debt Relief Act of 2007 (H.R. 3648) changes this for certain loans during the 2007 through 2014 tax years only.

The new law provides tax relief if your deficiency stems from the sale of your primary residence (the home that the homeowner live in). Here are the rules:

- **Loans for your primary residence.** If the loan was secured by your primary residence and was used to buy or improve that house, the homeowner may generally exclude up to $2 million in forgiven debt. This means the homeowner don't have to pay tax on the deficiency.
- **Loans on other real estate.** If the homeowner defaults on a mortgage that's secured by property that isn't your primary residence (for example, a loan on your vacation home), you'll owe tax on any deficiency.
- **Loans secured by but not used to improve primary residence.** If the homeowner takes out a loan, secured by the primary residence, but use it to take a vacation or send your child to college, the homeowner will owe tax on any deficiency.

The insolvency exception to tax liability. If the homeowner doesn't qualify for an exception under the Mortgage Forgiveness Debt Relief Act, the homeowner might still qualify for tax relief. If the homeowner can prove the homeowner was legally insolvent at the time of the short sale, the homeowner won't be liable for paying tax on the deficiency.

Legal insolvency occurs when your total debts are greater than the value of your total assets (your assets are the equity in your real estate and personal property). To use the insolvency exclusion, you'll have to prove to the satisfaction of the IRS that your debts exceeded the value of your assets.

Bankruptcy to avoid tax liability. The homeowner can also get rid of this kind of tax liability by filing for Chapter 7 or Chapter 13 bankruptcy, if the homeowner file before escrow closes. Of course, if the homeowner is going to file for bankruptcy anyway, there isn't much point in doing the short sale or deed in lieu of, because any benefit to your credit rating created by the short sale will be wiped out by the bankruptcy.

Rent Attachment – Cash Management Agreements

Submitted by James K. Murphy

ENFORCEMENT OF ASSIGNMENTS OF RENTS AND LEASES

For the most part, commercial mortgage transactions involve properties which are either the actual business location for the borrower or which are occupied by any number of tenants paying rent to the borrower. In the latter case, the commercial lender is interested in securing not only the real property but the leases, and rental payments thereunder, as well. Taking security in leases and rents and enforcing this security raises specific issues relating to registration, priority, notices and court approvals, issues which, although not overly complex, must be understood to ensure enforceable security for the commercial lender. This paper will canvas these issues and hopefully provide some practical insight in order to better protect your lender client.

1. ASSIGNMENTS OF LEASES AND RENTS - THE SECURITY DOCUMENTS

In circumstances where the borrower is a landlord for one or a number of tenants at the mortgaged premises, and the lender wishes to obtain security in the leases and the rents payable by the tenants, a separate assignment of leases and rents document may be obtained from the borrower in addition to the mortgage. Mortgage documents often contain provisions creating assignments of leases and rents in favor of the mortgagee.

There is sometimes a potential enforcement problem. Thus, it is arguable that any steps to enforce the assignment of rents provision in a mortgage must be taken at and supervised by the court. Usually, the action of serving notices on tenants requiring the tenants to pay rent to the lender is couched in immediacy and being forced to obtain court approval for such actions would be potentially troublesome for the lender.

Which to use - a general assignment of leases and rents or a specific assignment of leases? Most commercial mortgage transactions would dictate a general assignment, even if there is only one tenant. The general assignment document creates an interest in present and future leases and rents. Therefore, if the mortgaged premises are sub-divided so as to create more leased spaces or if tenants leave and new tenants sign on, the lender is protected and has security in these new leases and rents without requiring further documentation from the borrower.

A specific assignment of lease is used where the lender is interested in one particular lease only. Often this arises where the premises have one strong tenant under a long-term lease. In the particular circumstances, a general assignment may appear as overkill to the borrower. It should be remembered that a general assignment and a specific assignment create the same rights in the leases in favor of the lender.

Assignments of either kind will generally include a description of the leases or lease as the case may be. If you are taking a general assignment, the lack of lease descriptions is not fatal; however, it is suggested that descriptions be inserted to ensure both lender and borrower are in agreement as to the lease status of the mortgaged premises at the time of initial registration and funding. The assignment should use "including, but not limited to," language when referencing the lease descriptions, so as to not restrict the effect of the assignment to the described leases. Of course, in a specific assignment scenario, the lease description is absolutely required. Such descriptions would include name of tenant and landlord (if different from the borrower), date of lease, term of lease, any renewal options, and a description of any assignments by landlord or tenant to create a chain of title from the original lease document to the current borrower and tenant.

Finally, the assignment documents for either a specific or general assignment generally contain a provision allowing the borrower to continue to collect the rents under the leases affecting the mortgaged premises until such time as the lender delivers notice to the tenants to pay the rents to the lender. Only in rare circumstances does a lender wish to direct the rents to itself immediately upon the borrower executing the assignment. Presumably if the lender is concerned enough with the borrower to require the direction of rents immediately, then the entire loan program should be questioned. Normally, the borrower is allowed to operate the mortgaged premises in the ordinary course, collect the rents and make the scheduled loan payments to the mortgagee provided in the mortgage, loan agreement or promissory note as the case may be. This is more efficient administratively for the lender.

2. PRIORITY

An assignment of rents is deemed to be an interest in land and the assignment must be filed with the County Clerk. Priority is, therefore, the same as the priority for a mortgage or other encumbrance. A general assignment of leases and rents or a specific assignment of lease is to be filed against title to the mortgaged premises. Subject to the comments made earlier relating to enforcement, an assignment of rents provision in a mortgage, in all likelihood, meets the land titles registration requirement once the mortgage itself is recorded .[1]

If you search a particular title and do not find specific language related to an assignment of rents, remember to also check the wording of any prior recorded mortgage for a provision creating an assignment of rents. It would be unfortunate to assume "no filing, no assignment" only to later discover the clause in the recorded first mortgage to which your client would lose its presumed priority in the rents.

3. REVIEWING LEASES FOR LENDERS

When you receive instructions to act on a commercial mortgage transaction, those instructions may include the request to review the existing leases relating to the mortgaged premises for the lender. Some lenders undertake this review themselves, obtaining copies of the leases directly from the borrower or through lender's counsel. Other lenders place that task with their counsel as part of the security preparation and registration retainer. What interests lenders in the leases and what can be obtained from the tenants to provide additional comfort to lenders?

As may be obvious, lenders are primarily interested in who the tenant is, the term of the lease and the rent payable. Tenants of a "national" character (i.e., oil companies, department stores, convenience store chains), and the government are considered strong tenants. The covenant to pay rent, and, therefore, provide cash flow to the borrower, can be viewed with more stability when tenants of this nature are involved. If the tenant is unknown to the lender, it may be worthwhile to do some research related to the tenant. Related to this issue is whether the lease is supported by any guarantees. The existence of guarantees helps to bolster the covenant of the tenant, perhaps to a level acceptable to the lender.

With respect to term, it is preferable if all, or at least the major tenant leases, expire after the maturity of the loan in question. If such leases expire prior to maturity, the borrower could suffer a cash crunch if replacement tenants are not found. The lender is desirous of ensuring security of rent flow for the entire term of the loan. Where the property involves a number of leases (such as a shopping center), the leases should preferably have staggered expiry dates, again to protect against a sudden loss of cash flow during the term of the loan.

The amount of rent payable by the tenants should be reviewed and, in doing so, percentage rent can be ignored. Concentrate on base rent as percentage rent is an unknown quantity. Lenders wish to ensure that the amount of rent being paid by the tenants reflects market rents that are being charged elsewhere for similar premises. If the lender is from out of province, you may wish to obtain market rent information to assist in the review.

Related to the payment of rent are two other issues of note. First, does the lease allow the tenant to prepay rents? As you can appreciate, prepayment of rent is a potential nightmare for lenders when enforcement measures are taken. On occasion the lender will find the rent all prepaid and the assignment of no practical effect. Secondly, the nature of the lease (i.e., net to the landlord or gross) should be reviewed. If the lease is not a "net" lease, the financial obligations on the part of the borrower/landlord contained in the lease may affect its ability to service the loan repayment.

Tenant rights (in addition to the right to prepay rent) are also of interest to lenders. Does the tenant possess the right to terminate or surrender the lease without the consent of the borrower/landlord? If so, the risk of losing a tenant is increased, perhaps to an unacceptable level from the lender's perspective. It is preferable for the lease to allow damages and specific performance as remedies for tenants as compared to termination. Similarly, rights of set-off and rent abatement can affect rent flow, especially the former. If the event which gives rise to the right of set-off appears likely to occur, this should be brought to the attention of the lender.

Other issues which may be of some interest to a lender:

1. Insurance - are lease terms sufficiently onerous to create adequate funds to repair the building in a prompt manner, thus limiting the rent abatement period?;
2. Are the landlord covenants reasonable as the lender will be subject to such covenants in a foreclosure or receivership scenario?;
3. Assignment and sub-letting - how easy is it for a tenant to transfer its interest, perhaps to a less desirable tenant? Leases requiring the landlord to financially approve any assignee or sub-lessee provide comfort on this issue; and
4. Subordination, attornment and non-disturbance - do these provisions create an unreasonable burden on the landlord and the lender? (This issue will be discussed in more detail later in this paper.)

Having considered many if not all of these issues on behalf of your lender client, it always must be remembered that location can overcome a number of these problems if they exist. If the mortgaged premises are naturally rentable, tenants at market rent on reasonable lease terms can probably be found. Your lender client will be the ultimate judge of this issue.

In order to deal with some of the main issues raised above, and to provide greater protection to the lender, the security documents should include notices to tenants and tenant acknowledgments. (Examples of each document are attached to this paper.) The former document is a notice signed by the lender and provided to the tenant advising the tenant of the assignment of rents and putting the tenant on notice as to certain matters to which the landlord/borrower cannot agree without the lender's consent. The latter document (also known as an estoppel certificate) is provided by the tenant to the lender. It contains a confirmation of the present lease status, it acknowledges receipt of the notice from the lender, and it includes covenants on the tenant's part not to prepay rents, amend the lease or terminate or surrender the lease without the approval of the lender. The acknowledgment will serve to identify any existing landlord/tenant disputes or the prepayment of rent which would be of concern to a lender. As a practical note, it is preferable to put these notices and acknowledgments into the hands of the tenants (usually through the borrower's counsel) as soon as possible as tenants can be slow to return the acknowledgments. In the case of major tenant leases, funding should not proceed without the acknowledgments having been received.

Leases often contain provisions relating to subordination and attornment in favor of the landlord's lender and occasionally deal specifically with non-disturbance agreements. A subordination clause confirms the priority position of the lender over the particular lease which puts the lender in the position of being able to terminate this lease in the event of a foreclosure. The tenant agrees to formally register a postponement of any caveat in favor of the lender's mortgage. The attornment provision recognizes the lender as the landlord in the event of foreclosure and the tenant agrees to continue to be bound by the terms of the lease in such circumstances. Without anything further, these clauses place the lender in the most desired position from the point of view of control of the mortgaged premises.

In circumstances where the tenant has provided a subordination and attornment in favor of the lender, this tenant has a desire to ensure that its lease, and the occupancy of the mortgaged premises, will not be affected by any foreclosure proceedings. Often a substantial investment has been made by the tenant in leasehold improvements and the tenant wishes to fulfil the terms of the lease. Further, depending on the tenant, the lender itself may have an interest in ensuring that the lease continues as the mortgaged premises may be more marketable to potential purchasers with certain leases in place. The result is the execution of a non-disturbance agreement between the lender and the particular tenant. The lease review may reveal a provision requiring the landlord to obtain a non-disturbance agreement from any lender in favor of the particular tenant. Again, the acceptability of this provision to the lender may very well depend on the nature of the tenant. At the very least, if such a lease provision is acceptable to the lender, the form of non-disturbance agreement should be controlled by the lender.

5. ENFORCEMENT OF ASSIGNMENTS OF RENTS

As discussed above, an assignment of rents allows the borrower to collect the rents until the lender notifies the tenants otherwise. If default has occurred under the main loan documentation (usually in the form of non-payment of principal and/or interest), the lender will want to take control of the rents pursuant to the assignment as soon as possible. Notices must be provided to the tenants to pay future rents to the lender. There is no statutory form for such a notice; however, it should be sufficiently detailed to avoid any confusion on the part of the tenant. Circumstances often dictate that these notices be served immediately in order to catch the next rental payment date or to thwart the efforts of the borrower in making special arrangements with tenants. Personal service of the notices, even with the use of a bailiff, is recommended to guarantee receipt by the tenants but definitely certified mail should be used in order to have evidence of service. Once the notice is served, the lender collects the rents and enforces the lease in the place of the borrower as provided in the assignment document.

A matter to consider when providing the notice to tenants is potential bankruptcy issues. First, if a receiver is being appointed over rents, issues and profits, the requirements governing receivers must be followed.

Receivership

Submitted by Brad Salyer

KENTUCKY RECEIVERSHIP STATUTE

425.600 Appointment of receiver – Appeal from order appointing or refusing to appoint – Powers of receiver.

(1) On the motion of any party to an action who shows that he has, or probably has, a right to, a lien upon, or an interest in, any property or fund, the right to which is involved in the action, and that the property or fund is in danger of being lost, removed or materially injured, the court may appoint a receiver, or order the master commissioner to take charge of the property or fund during the pendency of the action, and may order and coerce the delivery of it to him. The order of a court appointing or refusing to appoint a receiver, shall be deemed a final order for the purpose of an appeal; Provided, that such order shall not be superseded.

(2) The receiver or master commissioner has, under the control of the court, power to bring and defend actions, respecting the property, to take and keep possession of the property, to receive rents, collect debts and generally to do such acts respecting the property as the court may authorize.

(3) Any income accruing during the pendency of proceedings under this section shall follow the property upon final disposition of the case.

Effective: January 2, 1978

History: Created 1976 (1st Extra. Sess.) Ky. Acts ch. 22, sec. 54, effective January 2, 1978.

INDIANA RECEIVERSHIP STATUTES

IC 32-30-5 Chapter 5.

Receiverships IC 32-30-5-1 Appointment of receivers; cases

Sec. 1. A receiver may be appointed by the court in the following cases:

(1) In an action by a vendor to vacate a fraudulent purchase of property or by a creditor to subject any property or fund to the creditor's claim. (2) In actions between partners or persons jointly interested in any property or fund. (3) In all actions when it is shown that the property, fund or rent, and profits in controversy are in danger of being lost, removed, or materially injured. (4) In actions in which a mortgagee seeks to foreclose a mortgage. However, upon motion by the mortgagee, the court shall appoint a receiver if, at the time the motion is filed, the property is not occupied by the owner as the owner's principal residence and: (A) it appears that the property is in danger of being lost, removed, or materially injured; (B) it appears that the property may not be sufficient to discharge the mortgaged debt; (C) either the mortgagor or the owner of the property has agreed in the mortgage or in some other writing to the appointment of a receiver; (D) a person not personally liable for the debt secured by the mortgage has, or is entitled to, possession of all or a portion of the property; (E) the owner of the property is not personally liable for the debt secured by the mortgage; or (F) all or any portion of the property is being, or is intended to be, leased for any purpose. (5) When a corporation: (A) has been dissolved; (B) is insolvent; (C) is in imminent danger of insolvency; or (D) has forfeited its corporate rights. (6) To protect or preserve, during the time allowed for redemption, any real estate or interest in real estate sold on execution or order of sale, and to secure rents and profits to the person entitled to the rents and profits. (7) In other cases as may be provided by law or where, in the discretion of the court, it may be necessary to secure ample justice to the parties.

As added by P.L.2-2002, SEC.15. Indiana Code 2015

IC 32-30-5-2 Persons prohibited from being appointed in particular action

Sec. 2. A court may not appoint: (1) a party; (2) an attorney representing a party; or (3) another person interested in an action; as a receiver in that action.

As added by P.L.2-2002, SEC.15.

IC 32-30-5-3 Receivers; oath; surety Sec. 3. Before beginning duties as a receiver, the receiver must: (1) swear to perform the duties of a receiver faithfully; and (2) with one (1) or more sureties approved by the court or judge, execute a written undertaking, payable to such person as the court or the judge directs, to the effect that the receiver will: (A) faithfully discharge the duties of receiver in the action; and (B) obey the orders of the court or judge.

As added by P.L.2-2002, SEC.15.

IC 32-30-5-4 Money or things controlled by party; delivery

Sec. 4. If it is admitted by the pleading or examination of a party that the party has in the party's possession or under the party's control any money or other thing capable of delivery, which: (1) is the subject of the litigation; (2) is held by the party as trustee for another party; or (3) belongs or is due to another party; the court or the judge may order the money or thing to be deposited in court or with the clerk, or delivered to the other party, with or without security, subject to the further order of the court or the judge.

As added by P.L.2-2002, SEC.15.

IC 32-30-5-5 Disobeyed order; delivery of money or thing; deposit

Sec. 5. If: (1) in the exercise of its authority, a court or judge has ordered the deposit or delivery of money or another thing; and (2) the order is disobeyed; the court or the judge, besides punishing the disobedience as contempt, may make an order requiring the sheriff to take the money or thing and deposit it or deliver it in conformity with the direction of the court or judge.

As added by P.L.2-2002, SEC.15. Amended by P.L.1-2003, SEC.85.

IC 32-30-5-6 Loan of deposited money prohibited; permitted with consent of parties

Sec. 6. Money deposited or paid into court or with the clerk in an action may not be loaned out unless consent is obtained from all parties having an interest in or making claim to the money.

As added by P.L.2-2002, SEC.15.

IC 32-30-5-7 Receiver's powers

Sec. 7. The receiver may, under control of the court or the judge: (1) bring and defend actions; (2) take and keep possession of the property; (3) receive rents; (4) collect debts; and (5) sell property; in the receiver's own name, and generally do other acts respecting the property as the court or judge may authorize.

As added by P.L.2-2002, SEC.15. Amended by P.L.177-2003, SEC.1.

IC 32-30-5-8 Defendant's admission; partial satisfaction of claim

Sec. 8. If the answer of the defendant admits part of the plaintiff's claim to be just, the court, on motion, may order the defendant to satisfy that part of the claim and may enforce the order by execution.

As added by P.L.2-2002, SEC.15.

IC 32-30-5-9 Time of receiver's appointment

Sec. 9. Receivers may not be appointed in any case until the adverse party has appeared or has had reasonable notice of the application for the appointment, except upon sufficient cause shown by affidavit.

As added by P.L.2-2002, SEC.15.

IC 32-30-5-10 Appeal; suspension of receiver's authority; surety

Sec. 10. (a) In all cases commenced or pending in any Indiana court in which a receiver may be appointed or refused, the party aggrieved may, within ten (10) days after the court's decision, appeal the court's decision to the supreme court without awaiting the final determination of the case. (b) In cases where a receiver will be or has been appointed, upon the appellant filing of an appeal bond: (1) with sufficient surety; (2) in the same amount as was required of the receiver; and (3) conditioned for the due prosecution of the appeal and the payment of all costs or damages that may accrue to any officer or person because of the appeal; the authority of the receiver shall be suspended until the final determination of the appeal.

As added by P.L.2-2002, SEC.15.

SAMPLE ORDER APPOINTING RECEIVER

CASE NO. 12-CI-402892

JEFFERSON CIRCUIT COURT
JUDGE FREDERIC J. COWAN
DIVISION THIRTEEN (13)

REPUBLIC BANK & TRUST COMPANY **PLAINTIFF**

v. **<u>ORDER APPOINTING RECEIVER</u>**

CLASSICKLE, INC., ET. AL. **DEFENDANTS**

***** *** *** *** *****

Upon Motion of the Plaintiff, Republic Bank & Trust Company, by counsel, and the Court having considered the arguments of counsel and is hereby sufficiently advised;

IT IS HEREBY ORDERED AND ADJUDGED as follows:

1. That AllTrade Service Solutions, LLC d/b/a AllTrade Property Management is hereby appointed Receiver of this Court to take and keep possession of property, and the improvements thereon, and to take those actions as more particularly described and set forth herein, on the following real property: 1708 Valley Forge Way, Louisville, Jefferson County, Kentucky, 40215; 1028 Hathaway Drive, Louisville, Jefferson County, Kentucky, 40215; 3225 Springfield Drive, Louisville, Jefferson County, Kentucky, 40214; 3200 Fordhaven Road, Louisville, Jefferson County, Kentucky, 40214; 4127 E. Indian Trail, Louisville, Jefferson County, Kentucky, 40213 (the “Property”).
2. That the owners of the Property identified shall, upon entry of this Order, turn over or cause to be turned over or delivered to the Receiver any and all deposits, security

deposits, advanced deposits, and cash on hand held by them, as well as copies of all lease agreements and agreements relative to rentals, rent rolls, correspondence, books, accounts, contracts, and records relating to the subject Property.

3. The Receiver shall have the power to take charge of, preserve, operate and care for, and maintain in good repair, and collect the rents, issues, and profits from the Property, and shall have the following specific powers:

   a. To take possession of the Property and any and all personal property used or associated therewith and to have, hold, use, operate, manage, and control the Property, the personal property, and each and every part thereof, except that any personal property owned by the Defendants Anthony and Stefani Sickles located at 4127 E. Indian Trail shall be removable by said Defendants upon communication with the Receiver;

   b. To commence such actions as may be necessary in its name as Receiver, to collect any sums due and owing the Defendants relative to the Property;

   c. To commence such action as may be necessary to preserve and protect the Property, the personal property, and the business conducted on the Property;

   d. To have, hold, use, manage, and control the Property and the personal property, and further to have, hold, use, manage, and control the books and records of the Property and any sums held on hand with respect to the subject Property;

   e. To keep the Property as well as any apparatus and equipment provided or required for use in connection with the operation of the Property, insured against liability during the pendency of the receivership;

f. To make all such necessary and proper repairs, renewals and replacements as the Receiver may deem judicious, to repair and keep the Property in good repair, and to enter into such contracts as are necessary to accomplish the foregoing;

g. To enter into or assume such contracts for services, supplies, and personal and/or real property necessary to aid the Receiver in the administration of the receivership and the operation of the business conducted on the Property, including the retention of attorneys and accountants to the extent deemed necessary and prudent by the Receiver (provided, however, that such employment and reasonable fees and expenses shall be first authorized by this Court), with all reasonable expenses incurred in connection therewith to be deemed expenses of the receivership;

h. To hire or discharge, out of income received from the Property, such employees as shall in the Receiver's reasonable judgment be necessary for the operation, maintenance and management of the Property and to pay such salaries as the Receiver shall determine and the expenses and taxes related thereto;

i. Upon taking possession of the Property to collect the income, rents, and profits (whether then due or thereafter becoming due) during the pendency of these proceedings and thereafter during any redemption period, deposit them in a separate account for the Property in the name of the Receiver, and to apply that income derived from the Property to the expenses for that Property, first to the payment of taxes, insurance premiums, utilities, and the necessary costs, expenses, and maintenance, repairs, leasing, salaries, and operation of the Property arising after the date of entry of this Order and to establish reserves for the payment of same, and for the payment of costs and expenses of this receivership and to maintain and hold an interest bearing escrow account for the Property for all other sums until further Order of this Court;

j. To make such expenditures as are reasonably necessary to put the Property in a condition such that it is suitable for lease, and if such necessary funds are unavailable from the lease income of the Property, to request such funds from Republic Bank & Trust Company, which funds shall be advanced and secured by the Property pursuant to the respective loan documents which are the subject of this action.

k. To collect any insurance and/or condemnation proceeds now or hereafter payable in connection with the Property; and

l. To do any and all acts necessary, convenient, and incidental to the foregoing.

4. The Receiver shall make a monthly accounting to the Court of the receipts and expenditures, and shall apply all rents, issues, and profits collected each month as set out above and shall forward a copy of same to all counsel of record in this action.

5. The Receiver shall execute a Bond for the faithful performance of its duties and for the account of all monies received by or coming into its account, which Bond shall be in the penal sum of $8,000.00, representing the estimated and approximate one month's gross rent potential of the Property, with surety thereon as acceptable to this Court.
6. This is a final and appealable Order and there is no just reason for delay of its entry or immediate execution.

This _______ day of __________, 2012.

____
JUDGE, JEFFERSON CIRCUIT COURT

Tendered By:

MORGAN & POTTINGER, P.S.C.

____
Bradley S. Salyer
601 West Main Street
Louisville, Kentucky 40202
(502) 589-2780
Counsel for Republic Bank & Trust Company

BANKRUPTCY LAW GOVERNING RECEIVERSHIP

11 U.S. Code § 543 - Turnover of property by a custodian

(a) A custodian with knowledge of the commencement of a case under this title concerning the debtor may not make any disbursement from, or take any action in the administration of, property of the debtor, proceeds, product, offspring, rents, or profits of such property, or property of the estate, in the possession, custody, or control of such custodian, except such action as is necessary to preserve such property.

(b) A custodian shall—

(1) deliver to the trustee any property of the debtor held by or transferred to such custodian, or proceeds, product, offspring, rents, or profits of such property, that is in such custodian's possession, custody, or control on the date that such custodian acquires knowledge of the commencement of the case; and

(2) file an accounting of any property of the debtor, or proceeds, product, offspring, rents, or profits of such property, that, at any time, came into the possession, custody, or control of such custodian.

(c) The court, after notice and a hearing, shall—

(1) protect all entities to which a custodian has become obligated with respect to such property or proceeds, product, offspring, rents, or profits of such property;

(2) provide for the payment of reasonable compensation for services rendered and costs and expenses incurred by such custodian; and

(3) surcharge such custodian, other than an assignee for the benefit of the debtor's creditors that was appointed or took possession more than 120 days before the date of the filing of the petition, for any improper or excessive disbursement, other than a disbursement that has been made in accordance with applicable law or that has been approved, after notice and a hearing, by a court of competent jurisdiction before the commencement of the case under this title.

(d) After notice and hearing, the bankruptcy court—

(1) may excuse compliance with subsection (a), (b), or (c) of this section if the interests of creditors and, if the debtor is not insolvent, of equity security holders would be better served by permitting a custodian to continue in possession, custody, or control of such property, and

(2) shall excuse compliance with subsections (a) and (b)(1) of this section if the custodian is an assignee for the benefit of the debtor's creditors that was appointed or took possession more than 120 days before the date of the filing of the petition, unless compliance with such subsections is necessary to prevent fraud or injustice.

(Pub. L. 95–598, Nov. 6, 1978, 92 Stat. 2595; Pub. L. 98–353, title III, § 458, July 10, 1984, 98 Stat. 376; Pub. L. 103–394, title V, § 501(d)(17), Oct. 22, 1994, 108 Stat. 4146.)

Troubled Debt Restructuring (TDR) Transactions

Submitted by Nick C. Thompson

The Five Axioms of Debt Restructuring

Restructuring troubled debt happens when the Debtor voluntarily gives up a benefit for a gain or concession from the bank who also voluntarily grants a right or asset. Restructuring happens when the bank has an opportunity to make a non-accrual loan into a loan in accrual status which will then pay out on time. Restructuring is defined as when "the creditor for economic or legal reasons related to the debtors financial difficulties grants a concession to the debtor that it would not otherwise consider". Accounting Standards Codification 310

Restructuring is proper when a lender avoids a loss greater than the cost of the concession granted to the Debtor. The benefit may be obtaining additional collateral to insure collection or just obtaining updated financial information. The restructuring is done to tighten compliance, avoid foreclosure, or otherwise improve collectability. The borrower normally trades some benefit to avoid foreclosure.

First Voluntary Loan Restructuring must proceed in good faith

Loan failures are often caused by the bank's failure to gather information in the loan processing, underwriting and closing process. In the rush to improve lending numbers, loan officers often push through unqualified loans that were bad deals for both the bank and the Debtor. This often causes defaults in the long run. In other cases, a change in material circumstances will cause a default when the debtor became unable to repay the loan after the loan was made. To get the bank to voluntarily restructure the loan you have to ask the bank to submit to restructuring. It is rare for a lender to volunteer to restructure the loan. Voluntary restructuring is the best chance the parties have for there to be a lasting resolution to the problem. However it is often difficult for the parties to come to terms. The bank and the Debtor may no longer have any hope that the loan will be successful.

For the loan to be restructured the bank has to look at the full picture of the borrower and the loan. Restructuring will often fail if the loan restructuring is merely an effort in desperation by the bank to grab additional security, increase profit or steal the equity. The Debtor has to see some advantage to the Debtor to agree to the restructuring. Unless the Debtor has the ability to pay and the willingness to repay there is no real opportunity to restructure in good faith on the part of the Debtor. Often the Debtor has lost so much faith in the process that the Debtor is merely stalling to find another property to move to. Similarly the Bank is often disillusioned and no longer has any trust in the debtor. The job of the lawyer is often to find a workable solution and to rebuild trust between the two.

Unless there is a real effort for a new relationship that will work for both parties there is no restructuring. The relationship between the debtor and the bank is often very much like a divorce. Both parties need to understand why the original relationship failed. If there is a chance at all for the bank to remain in business and the Debtor to remain a homeowner they have to work to understand why the old relationship didn't work. The have to work together and discover ways to insure a future relationship will be healthy and based on a more successful set of standards. If the bank will not agree voluntarily there may a chance to force restructuring upon the bank.

Second Debtors will not and can't pay for a debt that they can't afford.

If the Debtor cannot afford the present payment on a home because the interest rate or principle amount of the loan is too high, the payment must be lowered for any new loan to work. An interest rate reduction is often the most likely way to make a home or loan affordable. Bank software is often old and outdated. Bank software will rarely allow a reduction in the principle of a loan and making reductions to the principle is often difficult. It also creates a job on many accounting and operational levels within a bank. Rules and regulations within the lending industry make reducing the interest far more easy for lender operations than a reduction in the principle.

If the bank insists on terms that the Debtor cannot afford it is merely trading one defaulting loan for another defaulted loan. The Debtor may promise to pay. The Debtor may want to retain property. But unless the property is affordable after restructuring the lender should not just delay the inevitable. There are some cases where the Debtor has suffered such a calamity that even if the bank is generous in restructuring the debt the Debtor will never be able to afford the property.

Third Debtors will not pay for a loan that is a bad investment.

Even if the Debtor can afford a 200,000 dollar home they will not pay 200,000 for a 125,000 dollar home or pay a 8% interest rate if the normal rate is 4%. If you look at the recent foreclosure crisis many homes went back into foreclosure when the homeowners found out that they often owed 20% to 40% more for a home than what it was worth on the market. When consumers found out they paid overinflated prices they let these homes go back and refused to be taken advantage of by mortgage bankers and brokers who financed overvalued properties. These strategic foreclosures were chosen by the Debtor as an answer to negative equity positions. The bank was not choosing to foreclose, Instead it was the Debtor who chose foreclosure as an answer a mortgage with negative equity.

If it becomes cheaper to let the home go back in foreclosure or bankruptcy the Consumer will be properly advised by an attorney to let it go back. If the lender will not agree to voluntarily allow a restructuring it may be forced upon the bank in bankruptcy. The Debtor must offer something more than what the bank will get at foreclosure for restructuring to work but the bank must also offer value to the Debtor.

Fourth Bankruptcy offers a method to force Restructuring involuntarily

Bankruptcy offers what we called in the Marine Corp an alternative means of persuasion. This was also often called the 13 cent solution. It may not be what the bank wants but it is often what the bank gets if the bank refuses to voluntarily agree in good faith. It is often what is forced upon the bank and the debtor by a judge when parties fail to work with each other reasonably.

Bankruptcy for the Real Estate Investor or Business

During the foreclosure process we often found ourselves representing the real estate investor. One method which we used was to pick and choose which properties we kept. Often there was little or no equity in individual parcels of real property but there was often a positive cash flow for some and a negative cash flow for others. By only reaffirming the parcels of real property that had positive cash flows the real estate investor with 50 properties would keep perhaps 35 with positive cash flows and drop the toxic properties that were draining resources and bankrupting the business.

This method does not meet the definition of "restructuring" where the bank gives up a benefit to gain a benefit. But it does create a new relationship that works from the old relationship that didn't. Normally to restructure a loan the lender will want either

1. an extension of the maturity date,
2. transfer of additional assets to substitute for the property or
3. additional parties who guarantee the loan.

There may be a significant reason to continue the operation of the business but unless the company is making a profit and it has a positive cash flow the company should not normally continue its existence. I am constantly having to remind clients that staying in operation is a business decision. If the company is just eating up the assets there must be some proper reason for its continued existence. But all too often the owner of the business will stay in business long after it should have closed. At some point the attorney may violate his ethical duties if he allows this to continue.

Bankruptcy for the home owner

Some Debtors will proceed through the bankruptcy process in bad faith. The Debtor is faced with a 1099-c tax debt if the Debtor fails to file a bankruptcy prior to the sale. By filing prior to the sale there may be a delay in the process of the foreclosure. But this delay is often incidental to attempting everything else to save the home up to the moment the home is sold. The Debtor who seeks to make a loan affordable or seeks to avoid the tax consequences of a foreclosure files the case in good faith.

But there are also those who file repeated cases merely to delay the foreclosure process by litigating cases in state court and then filing a Chapter 13 in Bankruptcy court until it is thrown out there. By constantly going back and forth from bankruptcy court to state court and back to bankruptcy court in a never ending loop some couples have avoided the foreclosure process for over a decade. Switching back and forth between the husband and wife filing litigating and appealing can create an endless cycle.

There is no obstacle to obtaining a mortgage modification for the homeowner while the homeowner is in bankruptcy. Plus there are other tools that can modify the financial situation of the Debtor and in some cases modify or eliminate the debt. If the Debtor is attempting to save their home they may file a Chapter 13 and perhaps strip any second mortgage which has no real equity in the property. Under 11 USC 1322 (b) 2 the Debtor may modify the rights of secured claims,

"other than a claim secured only by security interest in real property that is the debtors primary residence,"

The first mortgage for the Debtors primary residence is therefore not generally modifiable in bankruptcy. However the first mortgages of business property, and vacation homes are modifiable. These properties may have their first mortgages modified by reducing the mortgage into secured and unsecured debt.

A second mortgage which has no equity in the home can be eliminated. Just by filing the motion to strip the mortgage company that previously resisted a modification may be brought to the table. The Creditor that refused a short sale may not have a choice if a Chapter 11 is filed and a sale is granted for the property. By stripping a second mortgage the home may become affordable. Discharging the unsecured debt may also make a home more affordable.

Fifth insure that there is an exchange for value to avoid a fraudulent transfer in bankruptcy.

For many lenders restructuring is an opportunity to take additional security or to take additional payments in the form of cash bank deposits or property. Unless the bank gives something of additional new value the transaction may become a fraudulent transfer in bankruptcy. In a restructuring the bank is rarely giving out additional funds. A mere delay in foreclosing is rarely enough consideration to support a transfer of assets from the debtor to the lender just prior to filing the bankruptcy. In that type of situation the bank will often be forced to disgorge the security or payment by the trustee or the debtor. To avoid this a bank should modify the loan terms, and or extend some additional benefit to the Debtor. The Debtor may pay normal payments to the bank prior to filing bankruptcy without causing a fraudulent transfer problem for the bank. But paying off the debt or any large transfer of assets may cause a fraudulent transfer problem for a lender.

Ethical Considerations When Dealing With Distressed Property

Submitted by Peter M. Gannott

ETHICAL CONSIDERATIONS WHEN DEALING WITH DISTRESSED PROPERTY

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INTRODUCTION

Whenever lawyers are involved in the practice of law, they must be ever-mindful of the legal ethics rules that are lurking in the background. Many times attorneys will unwittingly get caught in ethical traps. By thinking through some of the ethical issues in advance, lawyers are more likely to be able to deftly handle these issues appropriately when they present themselves.

Given the enormous breadth of the topic, it is virtually impossible to reduce to a brief article all factual issues which may arise in a workout and foreclosure setting. Consequently, the focus of this article will be on common ethics and professionalism issues in real estate workouts and foreclosures, coupled with a discussion of Kentucky's law on awarding attorney's fees.

A. CLIENT-LAWYER RELATIONSHIP – SCOPE OF REPRESENTATION

1. Introduction

It is not unusual for a lawyer to receive a file from a lending client without the scope of the representation being well defined. The duration of the representation may not be clear, and recurring work could continue for years. The understandings with the client about use of confidential information, and representation of the lender's interest vis-à-vis other lenders may remain unstated.

Example #1

Lawyer 1 and Lawyer 2 work at the same law firm. Lawyer 1 represents Lender A. Lender A made a secured loan to Newco1 for the purchase of property. Lawyer 1 assisted Lender A in the original loan transaction involving Newco1.

Lawyer 2 represents Lender B. Lender B loaned Newco2 capital secured by the assets of the business. Both loans are guaranteed by the same person, Guarantor. Both Newco 1 and Newco 2 are in financial trouble and the loans are underwater. Guarantor lacks sufficient assets to pay both lenders.

Historically, Lender A would expect Lawyer 1 to represent it in the defaulted loan to Newco 1 and Guarantor. However, Lender A has not yet forwarded the foreclosure file to Lawyer 1. Lender 2 comes to Lawyer B after Newco 2 defaults and asks for a "scorched earth approach" of litigation against Newco 2 and Guarantor.

At the time of the default, is Lender A the current or former client of the firm for purpose of analyzing the conflict of interest?

2. Determining the Scope of Representation

The contractual relationship between an attorney and client may be either expressed or implied by the conduct of the parties.

> The relationship is generally that of principal and agent; however, the attorney is vested with powers superior to those of any ordinary agent because of the attorney's quasi-judicial status as an officer of the court; thus the attorney is responsible for the administration of justice in the public interest, a higher duty than any ordinary agent owes his principal. Since the relationship of attorney-client is one

> fiduciary in nature, the attorney has the duty to exercise in all his relationships with this client-principal the most scrupulous honor, good faith and fidelity to his client's interest.

Daugherty v. Runner, 581 S.W.2d 12, 16 (Ky. 1978). Kentucky courts are under a duty to protect and preserve this relationship for the benefit of the general public. *See* **In re Gilbert,** 274 Ky. 187, 118 S.W.2d 535 (1938).

An attorney-client relationship may be created as a result of a party's "reasonable belief or expectation," based on the attorney's conduct, that the attorney has endeavored to undertake representation. ***Lovell v. Winchester,*** 941 S.W.2d 466, 468, 44 2 Ky. L. Summary 15 (Ky. 1997); **Am. Continental Ins. Co. v. Weber & Rose, P.S.C.**, 997 S.W.2d 12, (Ky. App.1998). Therefore, whether a party had a "reasonable belief or expectation" relating to the attorney's representation of that party's legal interests is a question of fact. ***Marrs v. Kelly,*** 95 S.W.3d 856 (KY 2003).

Like the formation of an attorney-client relationship, when the attorney-client relationship ceased is a factual issue. ***Branham v. Stewart,*** 307 S.W.3d 94 (Ky. 2010). Factors to be considered when deciding if the relationship has concluded "might include motions or orders of withdrawal from representation, letters to clients advising that representation has been concluded, or court documents showing that the attorney is no longer listed as attorney of record." ***Id.***

3. Privity is Not Required

An attorney is liable to those parties who are intended to benefit from his or her services "irrespective of any lack of privity." ***Hill v. Willmott,*** 561 S.W.2d 331, 334 (Ky. App. 1978); For example, in ***Seigle v. Jasper,*** 867 S.W.2d 476 (Ky.App.1993), the court held a title examiner owes a duty under Kentucky law to all parties involved in a real estate transaction, including the mortgage holder. In this case, a husband and wife received a general warranty deed for one property, and subsequently purchased another property from the same parties. They applied for a loan to purchase the second lot and to pay the balance owed on the first lot. An attorney performed the title examination for the loan. A few years later, the Seigles borrowed additional money. The same attorney wrote a second title letter to the bank.

The Seigles were never informed by the attorney in either of the title opinions that each of their lots was encumbered by an easement to Ashland Oil for an underground pipeline. When the Seigles learned of the easement, and were advised that placing improvements on the lots was an encroachment of the easement, they sued the attorney for negligence.

The attorney claimed he owed them no duty, as there was no privity of contract. The ***Seigle*** court rejected this argument and held the law in Kentucky is as follows:

> Where the abstracter knows, or should know, that his customer wants the abstract for the use of a prospective purchaser, and the prospect purchases the land relying on the abstract, <u>the abstracter's duty of care runs, as we have said, not only to his customer but to the purchaser</u>. <u>Moreover, others involved in the transaction through their relationship to the purchaser-such as lender-mortgagees, tenants and title insurers</u>-will also be protected where the purchaser's reliance was known or should have been known to the abstracter.

Seigle, 867 S.W.2d at 482 (emphasis added).

Seigle was based on section 552 of the *Restatement (Second) of Torts*, which states the following:

> [o]ne who, in the course of his business, profession or employment ... supplies false information for the guidance of others in their business transactions, is subject to liability for pecuniary loss caused to them by their justifiable reliance upon the information, if he fails to exercise reasonable care or competence in obtaining or communicating the information.

Restatement (Second) of Torts, sec. 552. Thus, the rule of ***Seigle*** applies to both lawyers and non-lawyers. ***Presnell Const. Managers, Inc. v. E.H. Const., LLC,*** 134 S.W.3d 575 (Ky. 2004).

4. The Use of an Engagement Letter

Legal malpractice cases and ethics issues may arise from disputes over the scope of an attorneys' representation of a client. For instance, an attorney handling a wrongful death action involving a motor vehicle accident was held to have been obliged to advise the client of a potential medical malpractice case. **Daugherty v. Runner,** 581 S.W.2d 12 (Ky. 1978).

These issues can be avoided – or at least made manageable – if the attorney has a written engagement letter. Thus, a properly drafted engagement letter is not only a critical risk management tool, but also forms the foundation of client communication and trust. Use of engagement letters should be mandatory in your practice.

Such an engagement letter was used in ***Bankers Trust of South Carolina v. Bruce,*** 283 S.C. 408, 323 S.E.2d 523 (Ct. App. 1984), when the court was called to decide if the firm could represent a debtor in a foreclosure action. The firm was on retainer to a bank to provide legal advice in seven specific areas, excluding litigation. Debtors in a foreclosure action brought by the bank sought to employ the firm. Applying the old code requirement that it must be "obvious" that the firm could adequately represent the interests of both clients, the court found that the standard was met in part because, in representing the debtors, the firm was representing only one side in the foreclosure action. Also, the lawyer involved in the foreclosure defense had performed little of the work in prior foreclosures in which the firm had represented the bank. Thus it was very unlikely that the lawyer had any special insight that hampered representation of debtors. Finally, the court pointed out, if anyone could object, it would be the bank, and it had consented

B. CONFLICTS OF INTEREST

1. Introduction

Real estate transactions, workouts and foreclosure actions may give rise to attorney conflicts of interests. These issues may arise in some of the following circumstances:

Example #1:

An associate attorney worked for a firm representing a lender during mediations of foreclosure cases. The associate attorney quit the firm and went to work for a new law firm representing Spanish speaking borrowers in defense of foreclosure actions. 50 percent of the associate's new firm's clients were in litigation with lenders represented by the associates' prior firm. After the associate was hired by the new firm, the conflict of interest issue was addressed for the first time. The associate attorney and firm had an agreement that the associate would not work on any cases where representation was provided by his former firm, unless a case was commenced after his new employment began.

<u>Can the associate attorney appear at a mediation for the borrower in a case where he previously filed a pleading on behalf of the lender?</u>

Example #2:

An attorney has a longstanding relationship with the borrower who engages in real estate transactions. The attorney is asked to represent the lender in a foreclosure action against the borrower. The attorney did not represent the borrower in the transaction that was the subject of the foreclosure.

<u>Can the attorney represent the lender in a foreclosure action against a borrower who is a long term client, when the attorney did not represent the borrower in connection with the transaction that is the subject of the foreclosure?</u>

See, Vermont Bar Association Advisory Opinion 87-18

Example #3:

An attorney represents a commercial bank which has litigation against an individual and corporations of which the individual is a stockholder, officer and director. The litigation involves promissory notes and security agreements drafted by the bank's law firm but for which the fee was an expense paid by the borrower. The individual executed guarantees in connection the loan.

<u>Can the attorney represent the lender in a foreclosure action against the borrower after the borrower paid the attorney for the document preparation?</u>

See, Professional Ethics of the Florida Bar, Opinion 71-18 (June 21, 1971)

2. Conflicts of Interest Involving Current Clients

When an attorney represents more than one client he/she cannot do so unless each party consents to the dual representation. Such consent may be made only after full disclosure is made by the attorney of the possible effect of such representation. However, there are some conflicts of interest that are irreconcilable and the attorney cannot waive.

Rule 1.7 covers conflicts of interest involving current clients:

> **SCR 3.130(1.7) Conflict of interest: current clients**
>
> (a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:
>
> > (1) the representation of one client will be directly adverse to another client; or
> >
> > (2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.
>
> (b) Notwithstanding paragraph (a), a lawyer may represent a client if:
>
> > (1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;
> >
> > (2) the representation is not prohibited by law;
> >
> > (3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and
> >
> > (4) each affected client gives informed consent, confirmed in writing. The consultation shall include an explanation of the implications of the common representation and the advantages and risks involved.

SCR 3.130(1.0) The “Terminology” section of the ethics rules define the phrases “confirmed in writing” and “informed consent as follows:

> (b) “Confirmed in writing,” when used in reference to the informed consent of a person, denotes informed consent that is given in writing by the person or a writing that a lawyer promptly transmits to the person confirming an oral informed consent. See paragraph (e) for the definition of an informed consent. If it is not feasible to obtain or transmit the writing at the time the person gives informed consent,

> then the lawyer must obtain or transmit it within a reasonable time thereafter.
>
> (e) "Informed consent" denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct.

Any waiver form signed at the eleventh hour will make it appear that the client had no real choice but to sign the consent. Thus, this issue should be resolved in advance.

A lawyer's professional responsibility must begin and end with concern for his client. When someone other than the client is paying the lawyer's bill, there is another ethics rule to consider. Rule 1.8 states as follows:

> **SCR 3.130(1.8) Conflict of interest: current clients; specific rules**
>
> (f) A lawyer shall not accept compensation for representing a client from one other than the client unless:
>
> (1) the client gives informed consent;
>
> (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and
>
> (3) information relating to representation of a client is protected as required by Rule 1.6.

Accordingly, if the lawyer knows he/she will not act independently, he/she cannot proceed with the transaction. Additionally, the attorney must consider the confidentiality provisions of ethics Rule 1.6, as well.

An example of an irreconcilable conflict of interest arose in ***Nunez v. Lovell,*** 50 V.I. 707, 2008 WL 4525835 (D.V.I. 2008), a foreclosure action on behalf of the lender against the owners of a condominium. Also named as a defendant was the condominium association, which was represented by attorney David Bornn. The lender filed a motion for default judgment against the condominium owners and summary judgment against the condominium association. Bornn, as attorney for the condominium association, filed a response to the motion. Thereafter, Bornn filed a motion to substitute parties on behalf of Chad and Venessa Nunez, who had purchased the lenders note.

When Bornn appeared at the hearing for both the Nunezes and condominium association, the Court ordered Bornn to explain why he was representing both the plaintiff and defendant. Burnn explained that the Nunezes were his former clients and officers of the condominium association. The Nunezes and the condominium association waived the conflict of interest. Bornn also claimed that the condominium association was a "nominal" party. The lender then retained a separate attorney, but Bornn still wanted to remain as attorney for the condominium association.

Bornn could not represent both the plaintiff and defendant, and he was disqualified from representing all parties in the case. The condominium association was not a "nominal" party, because it had a claim and was not a mere stakeholder.

3. Conflicts of Interest Involving Former Clients

Once a client becomes a former client, the lawyer has a continuing obligation not to take on representation of someone else in "the same or a substantially related matter" in which the prospective client's interests are "materially adverse" to the former client's unless the former client consents after consultation. SCR 3.130(1.9). As with Rule 1.7 Conflict of interest: current clients, the underlying premise of Rule 1.9 Duties to former clients is the duty of loyalty that lawyers owe to their clients. Rule 1.9 is concerned with the obligations that continue after the representation ends. The principal difference between Rule 1.7 and Rule 1.9 is that the conflict rules for current clients are stricter and apply in more situations.

Rule 1.9 relating to duties owed to former clients states as follows:

> **SCR 3.130(1.9) Duties to former clients**
>
> (a) A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the <u>same or a substantially related matter</u> in which that person's interests are <u>materially adverse</u> to the interests of the former client unless the former client gives informed consent, confirmed in writing.

What constitutes a "substantially related" matter can be very factually driven. Factors to consider may include:

- the similarities between the two factual situations;
- the legal questions posed;
- the nature and extent of the attorney's involvement in the first matter.

The second phase of the analysis is to determine whether the interests of the current and former clients are "materially adverse." A materially adverse situation can arise when a former client will be an adverse witness in the new client's legal matter. This situation can arise when a lawyer is involved with a real estate transaction on behalf of the former client and then seeks to represent the new client concerning the same transaction.

The next main focus of Rule 1.9 Duties to former clients is on the protection of confidential information. Analysis under this aspect asks whether the lawyer would have learned confidential information in the former representation that would be of significance in the subsequent representation. Rule 1.9(c) provides as follows:

> **SCR 3.130(1.9) Duties to former clients**
>
> (c) A lawyer who has formerly represented a client in a matter or whose present or former firm has formerly represented a client in a matter shall not thereafter:
>
> (1) <u>use information relating to the representation to the disadvantage of the former client except</u> as these Rules would permit or require with respect to a client, or when the <u>information has become generally known</u>; or
>
> (2) reveal information relating to the representation except as these Rules would permit or require with respect to a client.

This requires consideration of the kind of information that normally would have been available to a lawyer during the former representation, and whether the information presumed to be in the lawyer's possession is relevant to the new (adverse) matter so as to give the lawyer and the current client an advantage.

The rule establishes a presumption that all information as normally would have been obtained in the prior representation was in fact learned. The former client is thus spared from having to disclose the very information that is sought to be protected. On the other hand, not all information learned during the relationship will bar the subsequent representation of another party. The Comments to Rule 1.9 explain as follows:

> Information that has been disclosed to the public or to other parties adverse to the former client ordinarily will not be disqualifying. Information acquired in a prior representation may have been rendered obsolete by the passage of time, a circumstance that may be relevant in determining whether two representations are substantially related. In the case of an organizational client, general knowledge of the client’s policies and practices ordinarily will not preclude a subsequent representation; on the other hand, knowledge of specific facts gained in a prior representation that are relevant to the matter in question ordinarily will preclude such a representation.

Rule 1.9, Comment (3)

The duty to a former client may impact on whether the lawyer can undertake a new client. Rule 1.7 references duties owed to a former client as a basis for denying the new representation.

> **SCR 3.130(1.7) Conflict of interest: current clients**
>
> (a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:
>
> (4) the representation of one client will be directly adverse to another client; or
>
> (5) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

Therefore, whether the new representation is permitted will require a consideration of duties owed to the former client and whether the prior representation will “materially limit” the lawyers duties in the prospective representation.

Rule 1.9 Duties to former clients was applied by the Kentucky Supreme Court in ***Boggs v. Kentucky Bar Association,*** 999 S.W.2d 709 (Ky. 1999). In this case, attorney Boggs represented a married couple, who hired him to prepare deeds, evenly dividing their real estate among the couple's adult daughters. One daughter provided information to Boggs on her parents' behalf. Attorney Boggs prepared a deed in accordance with the information from the daughter, which later proved to be incorrect. After the deeds were filed, questions arose regarding the intentions of the parents. At the client's request, the attorney prepared two corrected deeds. The parents later sued that daughter and her husband for fraud for allegedly giving incorrect information to obtain more than her fair share of the real property and failing to execute the new deeds.

Boggs was retained as counsel by the defendant daughter and her husband; and Boggs filed an answer on their behalf. Boggs eventually withdrew as counsel, but only after his former clients (the parent couple) alleged that he had violated conflict of interest rules. Boggs claimed not to have recognized the conflict of interest at first, but later admitted to violating Rule 1.9(a), which provides that "[a] lawyer who has formerly represented a client in a matter shall not thereafter: represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client consents after consultation. ***Boggs,*** 999 S.W.2d at 709-10. The Court publicly reprimanded the attorney for his failure to secure the consent of the former clients and ordered that he forfeit all fees paid by the daughter.

It is worth noting that any conflict with a former client can be resolved through informed consent, confirmed in writing. Former client conflicts are always “waivable,” regardless of the degree of adversity between current and former client. Thus, an attorney should err on the side of obtaining informed written consent from the new and old clients, if there is even a hint of a conflict.

C. <u>LENDER LIABILITY ISSUES</u>

1. Introduction

Lenders often encounter borrowers who are unrepresented by legal counsel, especially when the debtor is encountering financial difficulties. As a result, borrowers may try to rely on lender's counsel for guidance on due diligence items, compliance with statutory requirements, entity formation issues, and terms of the agreement. When the borrower finds there is no way out of his/her financial predicament, borrowers are examining all possible defenses to the lender's enforcement actions. Consequently, when a debtor is pro se what is the appropriate response for lender and its counsel?

2. Dealing With Unrepresented Persons

The rising cost of legal services and cutbacks in legal aid have combined to cause a boom in go-it-alone litigants, who have become especially common in foreclosure cases. Like it or not, lawyers frequently must communicate on behalf of their clients with unrepresented individuals.

In this instance, the attorney must first determine whether the other party is represented by counsel. Kentucky Supreme Court Rule 3.130(4.2) provides as follows:

> **SCR 3.130(4.2) Communication with person represented by counsel**
>
> In representing a client, a lawyer shall not communicate about the <u>subject of the representation</u> with a person the lawyer <u>knows</u> to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order.

Rule 4.2 does not prohibit an attorney from asking unrepresented persons if they have a lawyer. The Rule only applies to communication with a represented person, or an employee or agent of such a person, concerning matters that are the "subject of the representation." .

Additionally, there is no violation of Rule 4.2 when the lawyer does not "know" that the other party is represented by counsel. The comment to this Rule provides as follows:

> This means that the lawyer has actual knowledge of the fact of the representation; but such actual knowledge may be inferred from the circumstances. See Rule 1.0(f). Thus, the lawyer cannot evade the requirement of obtaining the consent of counsel by closing eyes to the obvious.

SCR 3.130(4.2)

If the attorney reasonably believes the other party is pro se, he or she may proceed following the requirements of Supreme Court Rule 3.130(4.3) relating to unrepresented persons:

> **SCR 3.130(4.3) Dealing with unrepresented person**
>
> In dealing on behalf of a client with a person who is not represented by counsel, a lawyer shall not state or imply that the lawyer is disinterested. When the lawyer knows or <u>reasonably should know</u> that the unrepresented person misunderstands the lawyer's role in the matter, the lawyer shall make reasonable efforts to correct the misunderstanding. <u>The lawyer shall not give legal advice to an unrepresented person.</u> The lawyer may suggest that the unrepresented person secure counsel.

SCR 3.130(4.3). The phrase "reasonably should know" is a defined term under Kentucky's ethic's rules, stating as follows:

> **SCR 3.130(1.0) Terminology**
>
> (j) "Reasonably should know" when used in reference to a lawyer denotes that a lawyer of reasonable prudence and competence would ascertain the matter in question.

SCR 3.130(1.0).

Depending on the sophistication of the unrepresented party, it may be necessary or advisable to provide a written disclaimer confirming that the other party is pro se, advising that the attorney is not representing the pro se party and suggest that the unrepresented party obtain counsel.

Supreme Court Rule (4.3) bars the lawyer from giving any advice to the unrepresented party. However, it does not prohibit an attorney from discussing the matter with the pro se. The Comment states as follows:

> This Rule does not prohibit a lawyer from negotiating the terms of a transaction or settling a dispute with an unrepresented person. So long as the lawyer has explained that the lawyer represents an adverse party and is not representing the person, the lawyer may inform the person of the terms on which the lawyer's client will enter into an agreement or settle a matter, prepare documents that require the person's signature and explain the client's position as to the meaning of the document or explain the lawyer's view of the underlying legal obligations.

SCR 3.130(4.3), Comment 2.

3. Rule 4.2 Applies to Indirect Contacts

(a) <u>Rule 4.2 applies to contacts made to attorneys</u>

The rule prohibiting an attorney from contacting a party represented by counsel will apply where the opponent-party is an attorney represented by counsel, and the contacting attorney communicates with the attorney opponent-party, rather than their lawyer. Therefore, an attorney cannot directly contact in-house corporate counsel about a matter if the business is represented by an outside firm. ***Logan v. Cooper Tire & Rubber Co.,*** 2011 U.S. Dist. LEXIS 88622 (E.D. Ky. 2011) (Plaintiff's counsel was disqualified after writing a letter to defendant's in-house counsel in violation of S.C.R. 3.130 (4.2) suggesting a settlement meeting without outside defense counsel being present.).

On the other hand, a lawyer cannot contact a litigant through his/her attorney, if that attorney is not handling the matter at issue. ***Clemons v. Norton Healthcare, Inc.***, 2013 U.S. Dist. LEXIS 137106 (W.D. Ky. 2013) (Defense counsel violated S.C.R. 3.130 (4.2) by contacting a lawyer for a plaintiff who was a member of a class action, because that lawyer was not authorized to represent the plaintiff in the class action.).

(b) <u>Rule 4.2 applies to contacts made through agents</u>

Rule 4.2 will be violated if the attorney uses a third-party to make the ex parte communication that the attorney cannot. Rule 8.4 provides as follows:

> **SCR 3.130(8.4) Misconduct**
>
> It is professional misconduct for a lawyer to:
>
> (a) violate or attempt to violate the Rules of Professional Conduct, knowingly assist or induce another to do so, or do so through the acts of another; . . .

Rule 4.2 and Rule 8.4 came into play in ***Bratcher v. Kentucky Bar Ass'n***, 290 S.W.3d 648 (Ky. 2009). In this case, Bratcher was an attorney who represented a plaintiff in a wrongful termination action against his former employer. Bratcher hired a service that was involved in obtaining information on references given about former employees. The firm called the defendant company, identified herself as a potential employer of plaintiff and requested information on plaintiff. Defendant learned of the phone call when plaintiff produced the transcript of the call in discovery.

In the civil case, the court held the attorney violated Rules 4.2 and 8.2 and disqualified her from representing the plaintiff. In the ethics proceeding, the lawyer was given a public reprimand.

4. Rule 4.2 Only Applies When There is Actual Knowledge

There is no violation of Rule 4.2 when the lawyer does not "know" that the other party is represented by counsel. The comment to this Rule provides as follows:

> This means that the lawyer has actual knowledge of the fact of the representation; but such actual knowledge may be inferred from the circumstances. See Rule 1.0(f). Thus, the lawyer cannot evade the requirement of obtaining the consent of counsel by closing eyes to the obvious.

SCR 3.130(4.2)

D. MORTGAGE FORECLOSURE DEFENSE

1. Introduction

In the last several years, it was revealed that several large banks routinely pursued foreclosure of secured debts using affidavits signed by employees who did not personally review the documents and had no basis for believing that the homeowner was in default or that the bank owned the loan. Employees for financial giants like Bank of America, JP Morgan Chase, Wells Fargo, and GMAC have all testified that they signed many thousands of affidavits a month, spending about 30 seconds on each affidavit, and that they didn't have a clue regarding the veracity of the affidavit or the documents in question. The question becomes what are the ethical obligations of a lawyer in this situation?

2. The Ethics Rule Relating to Candor to the Tribunal

Lawyers are officers of the court and are thus obliged to be truthful and scrupulous in all dealings to protect the administration of justice. Without truthfulness, a court cannot function. Rule 3.3, seeks to protect the truth-seeking function of the court and to preserve the integrity of the judicial process. Rule 3.3 states as follows:

> (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 the tribunal when disclosure is necessary to avoid a fraud being perpetrated upon the tribunal;
>
> (3) 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 reasonable remedial measures.

S.C.R. 3.130 (3.1(a)).

The Comments to Rule 3.3 provide some further information on the lawyers' duties. Normally, an attorney will lack first-hand knowledge of the truth or falsity of a statement. In this situation, Rule 3.3 will not apply. However, when a lawyer knows the evidence is false, he/she must not proffer it to the court. Comment 4 to Rule 3.3 states as follows:

> **False Evidence**
>
> [4] When evidence that a lawyer knows to be false is provided by a person who is not the client, the lawyer must refuse to offer it regardless of the client's wishes.

Rule 3.3, Comment 4. The term "know" in the Kentucky Rules of Professional Conduct "denotes actual knowledge of the fact in question.

A lawyer who was unaware that the information was false at the time it was offered has a duty to correct the record "until the conclusion of the proceeding. Rule 3.1(b) states as follows:

> (b) The duties stated in paragraph (a) continue to the conclusion of the proceeding, and apply even if compliance requires disclosure of information otherwise protected by Rule 1.6.

S.C.R. 3.130 (3.1(b)).

3. The FDCPA and Consequences of Supplying False Evidence

Recent court decisions have imposed liability under the Fair Debt Collection Practices Act (FDCPA), 15 U.S.C., § 1692 –1692p, on mortgage servicers when foreclosing on a mortgage or other security interest. The FDCPA provides aggrieved consumers the right to file a private lawsuit to collect damages from third-party debt collectors. The FDCPA imposes strict liability on the debt collector for compliance with the statute. A single violation is sufficient to support judgment for the consumer.

Debt collectors are subject to the FDCPA. The term "debt collector" is a defined term under the FDCPA, which also includes "any person who uses any instrumentality of interstate commerce or the mails in any business the principal purpose of which is the enforcement of security interests." 15 U.S.C., § 1692a(6). Therefore, the FDCPA clearly regulates enforcers of security interests for purposes of compliance with Section 1692f(6). ***Currier v. First Resolution Inv. Corp.,*** 762 F.3d 529, 2014 U.S. App. LEXIS 15277 (6th Cir. 2014) (A threat to take illegal action existed where a debt collector filed and maintained an invalid lien on the consumer's house without a security interest in the property.).

Courts are divided on whether the other provisions of the FDCPA that proscribe certain activity "in connection with the collection of any debt" apply to enforcers of security interests to the same degree as traditional debt collection activity. *Compare* ***Wilson v. Draper & Goldberg, P.L.L.C.,*** 443 F.3d 373, 376 (4th Cir. 2006) (rejecting a foreclosure law firm's argument that foreclosure under a deed of trust is not the enforcement of an obligation to pay money, and finding that the FDCPA encompasses such activity), *with* ***Warren v. Countrywide Home Loans, Inc.,*** 342 F. App'x 458, 460 (11th Cir. 2009) ("enforcement of a security interest through the foreclosure process is not debt collection for purposes of the Act."); ***Boyd v. J.E. Robert Co., Inc.,*** 765 F.3d 123, 125 n.3 (2d Cir. 2014) (Second Circuit has not decided whether mortgage foreclosure constitutes debt collection under the FDCPA.).

Notably, the Sixth Circuit held in ***Glazer v. Chase Home Finance LLC,*** 704 F.3d 453 (6th Cir. 2013), that mortgage foreclosure constitutes debt collection under the FDCPA. In ***Glazer,*** plaintiff brought a FDCPA claim against Chase Home Finance ("Chase") and the law firm hired by Chase to foreclose on his property. Plaintiff claimed the lender and its attorneys violated the FDCPA by falsely claiming in the foreclosure complaint that Chase owned the note and mortgage. The district court granted the defendants' motions to dismiss for failure to state a claim under the FDCPA.

The Sixth Circuit affirmed the district court's dismissal of plaintiff's claims, because Chase was not a "debt collector". Chase obtained the mortgage loan prior to the loan going into default, which was the deciding factor. However, the court also concluded that mortgage foreclosure constitutes debt collection under the FDCPA.

The court explained that whether an obligation is a "debt" within the meaning of the act depends not on whether it is secured, but rather on the purpose for which it was incurred (i.e., primarily for personal, family, or household purposes). As such, a home loan, even if secured, is a "debt" within the meaning of the FDCPA. Moreover, the court construed the act as defining broadly what it considers debt collection, including conduct or communications in the course of a legal proceeding (i.e., foreclosure).

Based on this precedent, a lawyer who makes a false statement in violation of Rule 3.1 Meritorious Claims and Contentions may also be liable under the FDCPA. For example, in ***Todd v. Weltman, Weinberg & Reis Co., L.P.A.,*** 434 F.3d 432, 435 (6th Cir. 2006), the lawyers filed an affidavit as required by Ohio law to obtain a garnishment. The affidavit stated that "the affiant has a reasonable basis to believe that the person named in the affidavit as the garnishee may have property, other than personal earnings, of the judgment debtor that is not exempt under the law of this state or the United States." It turned out, debtor's assets were exempt. Debtor claimed the law firm violated the FDCPA because it "did not conduct a debtor's exam, did not undertake discovery as to whether Plaintiff possessed non-exempt assets, and otherwise had no factual basis for believing that Plaintiff's bank account contained non-exempt assets." The Sixth Circuit rejected the law firm's claim that its false affidavit was subject to complete judicial immunity. Thus, the FDCPA claim could proceed.

In this situation, Rule 3.1 suggests a lawyer is obligated to correct a false affidavit if they learn of the falsehood while the case is still pending. This obligation may also exist where the false affidavit is supplied by a client. For example, United Credit Recovery LLC purchased credit card debt from Wells Fargo and other institutions. The agreement for the purchase of the debt provided that Wells Fargo and other direct lenders would not provide affidavits after a certain time. When United Credit Recovery LLC needed proof to recover the credit card debt in court, it fabricated affidavits. The Colorado attorney general sued United Credit Recovery LLC ("UCR") claiming as follows:

> 52. UCR routinely copied bank officer signatures from documents it received from Wells Fargo and US Bank and inserted those signatures onto new, false, documents (the "False Bank Documents") created by UCR.
>
> 53. The False Bank Documents appeared to bear a bank officer's signature but were not actually signed by a bank officer.

> 54. The bank officer signatures on the False Bank Documents often were also notarized. UCR routinely copied legitimate notarizations from the documents it received from Wells Fargo and US Bank and inserted those notarizations onto the False Bank Documents.
>
> 55. The False Bank Documents are in the form of affidavits, notices, or similar documents that purport to provide the personal knowledge of a bank officer regarding a debt owed by a particular debtor.

Under these circumstances, the attorneys for United Credit Recovery LLC would have a duty to correct the record in any then pending case in which a false affidavit was filed.

E. ATTORNEYS' FEES AND EXPENSES AND GETTING PAID

1. Kentucky Generally Follows the "American Rule"

Generally, Kentucky courts apply the so-called American Rule regarding attorneys' fees. That rule requires that parties pay their own fees and costs and does not allow, as in the English courts, for the shifting of the prevailing party's fees to the loser. ***Bell v. Commonwealth***, 423 S.W.3d 742 (Ky. 2014). The "American Rule" permits the recovery of attorney fees by the prevailing party when there is a specific contractual provision or fee-shifting statute which allows recovery. ***Batson v. Clark,*** 980 S.W.2d 566, (Ky. App. 1998).

KRS 411.195 expressly permits enforcement of an attorney's fees provision in a contract, and states as follows:

> Any provisions in a writing which create a debt, or create a lien on real property, requiring the debtor, obligor, lienor or mortgagor to pay reasonable attorney fees incurred by the creditor, obligee or lienholder in the event of default, shall be enforceable, provided, however, such fees shall only be allowed to the extent actually paid or agreed to be paid, and shall not be allowed to a salaried employee of such creditor, obligor or lienholder.

KRS 411.195.

Of course, there are numerous fee-shifting statutes under Kentucky and federal law, which can provide some insights and useful case authority when evaluating fees. Of particular note is the Fair Debt Collection Practices Act (FDCPA), which gives aggrieved consumers the right to file a private lawsuit in a state or federal court to collect damages from third-party debt collectors. A single violation is sufficient to support judgment for the consumer. A successful consumer is entitled to an award of actual damages, statutory damages, court costs and attorney's fees. 15 U.S.C. § 1692k(a).

Despite the general prohibition on recovering attorneys' fees when no contract or statute so provides, there are decisions stating that this rule does not abolish the equitable principle that a trial court can rely upon its powers in equity to make an award of attorney fees. ***Kentucky State Bank v. AG Services, Inc***., 663 S.W.2d 754, 755 (Ky. App. 1984) ("equitable rule that an award of counsel fees is within the discretion of the court depending on the circumstances of each particular case."). When awarding fees, a trial court may consider bad faith, or whether a suit is frivolous. However, the circumstances justifying an equitable award of attorney fees "have never been spelled out." ***Cummings v. Covey,*** 229 S.W.3d 59, 62 (Ky. App. 2007)

2. The Method for Determining a Reasonable Attorney Fee

A dispute over the right to recover attorneys' fees occurs in three basic circumstances. First, the lawyer is pursuing his own client to recover fees due from the client. Second, the prevailing party is entitled to recover attorneys' fees from the loser based on a fee-shifting statute. Third, the prevailing party is pursuing attorneys' fees from the loser based on a fee-shifting provision in promissory note, mortgage or other agreement. An example of this circumstance arises when the lender successfully forecloses on property, and the prevailing party is entitled to recover "reasonable attorneys' fees and costs." All three situations implicate many of the same ethics rules, but may lead down different paths.

When attorneys' fees are due to be paid, both the jury and judge must answer the same fundamental question: how much in fees and costs is "reasonable"?

(a) <u>Lawyers' Claims Against Their Clients – Ethics Rule 1.5</u>

When a case is decided under Kentucky state law, the determination of how the court is to determine what is reasonable may depend on the nature of the action. When suit is brought by a lawyer against his client to recover attorneys' fees, the court can consider the factors listed in Rule 1.5 of the Kentucky Rules of Professional Conduct, SCR 3.130. ***Brown v. Fulton, Hubbard & Hubbard,*** 817 S.W.2d 899 (KY App. 1991). That Rule states as follows:

> (a) A lawyer's fee shall be reasonable. Some factors to be considered in determining the reasonableness of a fee include the following:
>
> (1) The time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;
>
> (2) The likelihood that the acceptance of the particular employment will preclude other employment by the lawyer;
>
> (3) The fee customarily charged in the locality for similar legal services;
>
> (4) The amount involved and the results obtained;
>
> (5) The time limitations imposed by the client or by the circumstances;
>
> (6) The nature and length of the professional relationship with the client;
>
> (7) The experience, reputation, and ability of the lawyer or lawyers performing the services; and
>
> (8) Whether the fee is fixed or contingent.

SCR 3.130 (Rule 1.5).

The result achieved when these eight factors are applied to a fee agreement does not necessarily dictate whether the fee agreement between the client and lawyer is enforceable. ***KY Bar Association v. Fernandez,*** 397 S.W.3d 363 (KY 2013), concerned a disciplinary action brought against the attorney for the estate of Claudia E. Sanders

("Sanders"), widow of the late Colonel Harland Sanders of Kentucky Fried Chicken © ("KFC") fame. The Supreme Court suspended the attorney for 91 days, with 61 days probated, where she violated SCR 3.130-1.5(a) by collecting excessive fees from an estate, in violation of KRS 396.150(1). The Court explained as follows:

> It is important to clarify that a determination that a fee is excessive in a civil suit is not the same as a determination that a fee is unreasonable under SCR 3.130-1.5(a). For example, a fee may be excessive in a civil suit because it is more than agreed upon in a contract, if there were no agreed to amendments, but that same fee may not be unreasonable in a disciplinary proceeding once viewed in light of the factors listed under SCR 3.130-1.5(a), as well as any other relevant factor.

Bar Association v. Fernandez, 397 S.W.3d 363, n. 7 (KY 2013). The fee was unreasonable, because the attorney was paid for work representing other estates, although Claudia Sanders' will contained no provision for these fees.

(b) <u>Statutory Claims – The Lodestar Approach</u>

A party seeking attorney's fees under a federal fee shifting statute such as the FDCPA bears the burden to show she is entitled to the amount requested. ***Hensley v. Eckerhart***, 461 U.S. 424, 433, 103 S. Ct. 1933, 76 L. Ed. 2d 40 (1983); ***Reed v. Rhodes***, 179 F.3d 453, 472 (6th Cir. 1999). A reasonable fee is one that is "adequately compensatory to attract competent counsel yet which avoids producing a windfall for lawyers." ***Geier v. Sundquist,*** 372 F.3d 784, 791 (6th Cir. 2004); ***Adcock-Ladd v. Sec'y of Treasury***, 227 F.3d 343, 349 (6th Cir. 2000).

Attorney fees in FDCPA cases are generally calculated based upon a "lodestar" analysis. ***Dowling v. Litton Loan Servicing, LP***, 320 F. App'x 442, 446 (6th Cir. 2009). The lodestar method requires multiplying the proven number of hours reasonably expended by the professional on the case by a reasonable hourly rate. ***Hensley v. Eckerhart***, 461 U.S. 424, 433 (1983); ***In re Boddy,*** 950 F.2d 334, 337 (6th Cir. 1991). There is a "strong presumption that the lodestar figure--the product of reasonable hours times a reasonable rate--represents a 'reasonable' fee . . ." ***Pennsylvania v.***

Delaware Valley Citizens' Council for Clean Air, 483 U.S. 711 (1987); ***Perdue v. Kenny A. ex rel. Winn***, 130 S. Ct. 1662 (2010).

"To arrive at a reasonable hourly rate, courts use as a guideline the prevailing market rate, defined as the rate that lawyers of comparable skill and experience can reasonably expect to command within the venue of the court of record." ***Geier v. Sundquist,*** 372 F.3d 784, 791 (6th Cir. 2004). This "community market principle" allows the Court to consider the requesting attorney's well-defined billing rates within a broader community-wide market to determine the reasonableness of the fees. ***Hadix v. Johnson,*** 65 F.3d 532, 536 (6th Cir. 1995). "The appropriate rate, therefore, is not necessarily the exact value sought by a particular firm, but is rather the market rate in the venue sufficient to encourage competent representation." ***Gonter v. Hunt Valve Co., Inc.,*** 510 F.3d 610, 618 (6th Cir. 2007).

Once the lodestar analysis makes an initial estimate of the value of a lawyer's services, the product may then be adjusted based upon other considerations which include the results obtained and the quality of representation. Courts may adjust that amount upward or downward based on the twelve-factor ***Johnson*** test, which the Supreme Court found "useful" in ***Blanchard v. Bergeron,*** 489 U.S. 87, 93 (1989). These twelve "*Johnson*" factors are as follows:

> (1) the time and labor required; (2) the novelty and difficulty of the questions; (3) the skill requisite to perform the legal service properly; (4) the preclusion of other employment by the attorney due to the acceptance of the case; (5) the customary fee; (6) whether the fee is fixed or contingent; (7) time limitations imposed by the client or the circumstances; (8) the amount involved and the results obtained; (9) the experience, reputation, and ability of the attorneys; (10) the "undesirability" of the case; (11) the nature and length of the professional relationship with the client; and (12) awards in similar cases.

Graceland Fruit, Inc. v. KIC Chems., Inc., 320 F. App'x 323, 328-29 (6th Cir. 2008) (*quoting* ***Johnson v. Ga. Hwy. Express, Inc.,*** 488 F.2d 714, 717-19 (5th Cir. 1974)).

The Sixth Circuit has stated that adjustments should be made only in "rare" and "extraordinary" circumstances, because many of these *Johnson* factors are subsumed within the lodestar calculation. ***Geier v. Sundquist,*** 372 F.3d 784, 792 (6th Cir. 2004). Thus, modification to the lodestar figure — either up or down — should be made only "in exceptional circumstances." ***Perdue v. Kenny A. ex rel. Winn***, 130 S. Ct. 1662 (2010); ***In re Belknap, Inc.,*** 103 B.R. 842, 843 (W.D. Ky. 1989).

In ***Coulter***, the Sixth Circuit concluded that time spent in preparing, presenting, and trying attorney fee applications is compensable. The Court did place the following limitations on such awards:

> In the absence of unusual circumstances, the hours allowed for preparing and litigating the attorney fee case should not exceed 3% of the hours in the main case when the issue is submitted on the papers without a trial and should not exceed 5% of the hours in the main case when a trial is necessary. Such guidelines and limitations are necessary to insure that the compensation from the attorney fee case will not be out of proportion to the main case and encourage protracted litigation.

Id. Case law from the Sixth Circuit suggests that attorney's fees for the prosecution of a fee motion should be limited to 3% of the amount actually awarded, not 3% of the amount originally sought. *See* **Gonter v. Hunt Valve Co.,** 510 F.3d 610, 621 (6th Cir. 2007) (applying the 3% rule to the district court's lodestar award, which was calculated using an hourly billing rate that "effectively reduced the lodestar by twenty percent" from the original lodestar amount sought).

(c) Contract Claims – The Reasonable Value of Bona Fide Legal Services

Many contracts provide that attorneys' fees are to be paid to the "prevailing party." When the right to attorneys' fees arises from a fee-shifting contract, Kentucky holds that the attorney fee must reflect the "reasonable value of bona fide legal services**."** ***Capitol Cadillac Olds, Inc. v. Roberts,*** 813 S.W.2d 287, 293 (Ky. 1991) (analyzing the reasonableness of an attorneys' fee award made under an installment contract with a fee-shifting provision); ***A & A Mechanical, Inc. v. Thermal Equipment Sales, Inc.,*** 998 S.W.2d 505, 509 (Ky. App. 1999) (concluding that the amount of an attorneys' fees award is generally within the discretion of the trial court, and that parties must prove the fee request is not excessive and reflects the "reasonable value of bona fide legal services").

In ***Capitol Cadillac***, the court explained that "it should never be overlooked that any award of an attorney fee is subject to a determination of reasonableness by the trial court." ***Capitol Cadillac Olds, Inc. v. Roberts,*** 813 S.W.2d 287, 293 (Ky. 1991). The court also found trial court judges are "in the best position to consider all relevant factors" before awarding a fee. *Id.* Accordingly, the court found that a trial court, in exercising its discretion, should assess fees after parties "demonstrate that the amount sought is not excessive and accurately reflects the reasonable value of bona fide legal expenses incurred." *Id.*

It seems likely that Kentucky courts will follow the lodestar approach, even if they do not call it such. For example, in ***Fenley v. Fenley,*** 2012-CA-000781-MR, 2013 Ky. App. Unpub. LEXIS 743 (Ky. Ct. App. Sept. 13, 2013), the trial court awarded attorneys' fees based on evidence that the large number of hours were supported by the amount of litigation and the hourly rate was within the range charged by other lawyers with similar experience. The court of appeals explained as follows:

> The record shows that the circuit court's award was not arbitrary or unreasonable. In awarding attorneys' fees and costs, the court noted that this case has involved approximately 38 months of litigation, twenty pleadings filed by Joe, discovery, and one deposition. Six different attorneys worked on Joe's case for a total of roughly 340 hours. The affidavit submitted in support of Joe's motion for attorneys' fees reflects an hourly rate that the circuit court found comparable with that of other attorneys of equivalent skill and experience.

Fenley v. Fenley, 2012-CA-000781-MR, 2013 Ky. App. Unpub. LEXIS 743 (Ky. Ct. App. Sept. 13, 2013).

Additionally, there is some Kentucky support for applying other factors when deciding on whether attorneys' fees and costs are due to be paid. For example, the Supreme Court in ***Capitol Cadillac***, 813 S.W.2d at 293, stated that "due regard" should be given for Rule 1.5 of the Kentucky Rules of Professional Conduct, when deciding a fee dispute. Additionally, the Court in ***Tomeo v. Rubarts,*** No. 2002-CA-002464-MR, 2003 WL 22872406, at *2 (Ky. App. 2003), provided a four-factor test that may be used to decide whether a party requesting an award of attorneys' fees pursuant to a contract provision is entitled to a fee recovery for defending a claim by the party opposing payment of such fees.

3. Function of Court and Jury

The decision on the amount of attorneys' fees to award is for the jury, when the lawyer is seeking payment of the fee from his client. ***Inn-Group Management Services, Inc. v. Greer***, 71 S.W.3d 125, 130 (Ky.App. 2002).

Conversely, it is the responsibility of the trial court, and not the jury, to determine the availability and amount of attorney fees when the action seeks recovery of attorneys' fees from a third party. ***Inn-Group Management,*** 71 S.W.3d at 130 ("What constitutes a reasonable attorney fee . . . is an issue of law when the attorney and/or client seeks to recover a reasonable attorney fee from an opposing or third party."). When the right to attorneys' fees is due to be paid to the prevailing party based on the terms of a contract or fee shifting statute, the fee amount lies within the sound discretion of the circuit court. ***Ford v. Beasley,*** 148 S.W.3d 808 (Ky. App. 2004). Such an award will not be disturbed on appeal absent an abuse of discretion.

It is important to note, however, that the abuse of discretion standard does not give the trial court unlimited authority over the attorney fee award. This principal is seen in ***Smith Rental Enterprises v. Jeff Stewart,*** 2008 Ky. App. Unpub. LEXIS 803 (KY App. 2008), which held that the trial court abused its discretion when it denied the recovery of all attorneys' fees and costs, although the lease contained a provision permitting such a recovery and the landlord prevailed. In this case, the landlord learned that the tenant had a dog residing at the rental home, in violation of the lease. The landlord sued for damage to the carpet and for painting, and was given an award by the jury. In reversing the trial court's denial of attorneys' fees, the Court of Appeals explained as follows:

> After considering the arguments of the parties, we conclude that Smith, as the prevailing party, was entitled to a reasonable award of attorney's fees pursuant to the agreed-upon terms of the lease. Consequently, the trial court abused its discretion by arbitrarily denying Smith's motion for attorney's fees.

Smith Rental Enterprises

According to Kentucky case precedent, trial courts have broad discretion when determining the reasonableness of attorney's fees sought under a fee-shifting statute or contractual provision. A trial court will be deemed to have abused that discretion, however, where it denies an award of attorney's fees that the attorney is entitled. An attorney would be prudent to always include a provision for attorney's fees when drafting a real estate contract on behalf of a lender.

CONCLUSION

Transferring ownership of real estate from one party to another is inherently susceptible to entangling lawyers in obvious and not so obvious legal issues. The likelihood of encountering problems arises from the large number of transactions and combinations of parties with differing interests. Considering the economic problems plaguing the real estate markets, it is not surprising that attorneys have been seen as a potential source of recovery when transactions fail. Therefore, attorneys handling real estate workouts and foreclosures should be familiar with the most common and challenging legal ethical issues to guard against potential liability.

ETHICAL CONSIDERATIONS WHEN DEALING WITH DISTRESSED PROPERTY

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APPENDICES

APPENDIX A

SCR 3.130(1.0) Terminology

(a) "Belief" or "believes" denotes that the person involved actually supposed the fact in question to be true. A person's belief may be inferred from circumstances.

(b) "Confirmed in writing," when used in reference to the informed consent of a person, denotes informed consent that is given in writing by the person or a writing that a lawyer promptly transmits to the person confirming an oral informed consent. See paragraph (e) for the definition of an informed consent. If it is not feasible to obtain or transmit the writing at the time the person gives informed consent, then the lawyer must obtain or transmit it within a reasonable time thereafter.

(c) "Firm" or "law firm" denotes a lawyer or lawyers in a, law partnership, professional corporation, sole proprietorship or other association authorized to practice law; or lawyers employed in a legal services organization or the legal department of a corporation or other organization.

(d) "Fraud" or "fraudulent" denotes conduct that is fraudulent under the substantive or procedural law of the applicable jurisdiction and has a purpose to deceive.

(e) "Informed consent" denotes the agreement by a person to a proposed course of conduct after the lawyer has communicated adequate information and explanation about the material risks of and reasonably available alternatives to the proposed course of conduct.

(f) "Knowingly," "known," or "knows" denotes actual knowledge of the fact in question. A person's knowledge may be inferred from circumstances.

(g) "Partner" denotes a member of a partnership, a shareholder in a law firm organized as a professional corporation, or a member of an association authorized to practice law.

(h) "Reasonable" or "reasonably" when used in relation to conduct by a lawyer denotes the conduct of a reasonably prudent and competent lawyer.

(i) "Reasonable belief" or "reasonably believes" when used in reference to a lawyer denotes that the lawyer believes the matter in question and that the circumstances are such that the belief is reasonable.

(j) "Reasonably should know" when used in reference to a lawyer denotes that a lawyer of reasonable prudence and competence would ascertain the matter in question.

(k) "Screened" denotes the isolation of a lawyer from any participation in a matter through the timely imposition of procedures within a firm that are reasonably adequate under the circumstances to protect information that the isolated lawyer is obligated to protect under these Rules or other law.

(l) "Substantial" when used in reference to degree or extent denotes a material matter of clear and weighty importance.

(m) "Tribunal" denotes a court, an arbitrator in a binding arbitration proceeding or a legislative body, administrative agency, disciplinary or admissions entity created by the Supreme Court, or other body acting in an adjudicative capacity. A legislative body, administrative agency or other body acts in an adjudicative capacity when a neutral official, after the presentation of evidence or legal argument by a party or parties, will render a binding legal judgment directly affecting a party's interests in a particular matter.

(n) "Writing" or "written" denotes a tangible or electronic record of a communication or representation, including handwriting, typewriting, printing, photostating, photography, audio or video-recording and e-mail. A "signed" writing includes an electronic sound, symbol or process attached to or logically associated

APPENDIX B

SCR 3.130(1.2) Scope of representation and allocation of authority between client and lawyer

(a) Subject to paragraphs (c) and (d), a lawyer shall abide by a client's decisions concerning the objectives of representation and, as required by Rule 1.4, shall consult with the client as to the means by which they are to be pursued. A lawyer may take such action on behalf of the client as is impliedly authorized to carry out the representation. A lawyer shall abide by a client's decision whether to settle a matter. In a criminal case, the lawyer shall abide by the client's decision, after consultation with the lawyer, as to a plea to be entered, whether to waive jury trial and whether the client will testify.

(b) A lawyer's representation of a client, including representation by appointment, does not constitute an endorsement of the client's political, economic, social or moral views or activities.

(c) A lawyer may limit the scope of the representation if the limitation is reasonable under the circumstances and the client gives informed consent.

(d) A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.

APPENDIX C

SCR 3.130(1.7) Conflict of interest: current clients

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer's responsibilities to another client, a former client or a third person or by a personal interest of the lawyer.

(b) Notwithstanding paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

(3) the representation does not involve the assertion of a claim by one client against another client represented by the lawyer in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing. The consultation shall include an explanation of the implications of the common representation and the advantages and risks involved.

APPENDIX D

SCR 3.130(1.8) Conflict of interest: current clients; specific rules

(a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

(1) the transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing in a manner that can be reasonably understood by the client;

(2) the client is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel on the transaction; and

(3) the client gives informed consent, in a writing signed by the client, to the essential terms of the transaction and the lawyer's role in the transaction, including whether the lawyer is representing the client in the transaction.

(b) A lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client gives informed consent, except as permitted or required by these Rules.

(c) A lawyer shall not solicit any substantial gift from a client, including a testamentary gift, or prepare on behalf of a client an instrument giving the lawyer or a person related to the lawyer any substantial gift unless the lawyer or other recipient of the gift is related to the client. For purposes of this paragraph, related persons include a spouse, child, grandchild, parent, grandparent or other relative or individual with whom the lawyer or the client maintains a close, familial relationship.

(d) Prior to the conclusion of representation of a client, a lawyer shall not make or negotiate an agreement giving the lawyer literary or media rights to a portrayal or account based in substantial part on information relating to the representation.

(e) A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that:

(1) a lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter; and

(2) a lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client.

(f) A lawyer shall not accept compensation for representing a client from one other than the client unless:

(1) the client gives informed consent;

(2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and

(3) information relating to representation of a client is protected as required by Rule 1.6.

(g) A lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the clients, or in a criminal case an aggregated agreement as to guilty or nolo contendere pleas, unless each client gives informed consent, in a writing signed by the client. The lawyer's disclosure shall include the existence and nature of all the claims or pleas involved and of the participation of each person in the settlement.

(h) A lawyer shall not:

(1) make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless the client is independently represented in making the agreement; or

(2) settle a claim or potential claim for such liability with an unrepresented client or former client unless that person is advised in writing of the desirability of seeking and is given a reasonable opportunity to seek the advice of independent legal counsel in connection therewith.

(i) A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may:

(1) acquire a lien authorized by law to secure the lawyer's fee or expenses; and

(2) contract with a client for a reasonable contingent fee in a civil case.

(j) A lawyer shall not have sexual relations with a client unless a consensual sexual relationship existed between them before the client-lawyer relationship commenced.

(k) While lawyers are associated in a firm, a prohibition in the foregoing paragraphs (a) through (i) that applies to any one of them shall apply to all of them.

APPENDIX E

SCR 3.130(1.9) Duties to former clients

(a) A lawyer who has formerly represented a client in a matter shall not thereafter represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client gives informed consent, confirmed in writing.

(b) A lawyer shall not knowingly represent a person in the same or a substantially related matter in which a firm with which the lawyer formerly was associated had previously represented a client

(1) whose interests are materially adverse to that person; and

(2) about whom the lawyer had acquired information protected by Rules 1.6 and 1.9(c) that is material to the matter; unless the former client gives informed consent, confirmed in writing.

(c) A lawyer who has formerly represented a client in a matter or whose present or former firm has formerly represented a client in a matter shall not thereafter:

(1) use information relating to the representation to the disadvantage of the former client except as these Rules would permit or require with respect to a client, or when the information has become generally known; or

(2) reveal information relating to the representation except as these Rules would permit or require with respect to a client.

APPENDIX F

SCR 3.130(4.2) Communication with person represented by counsel

In representing a client, a lawyer shall not communicate about the subject of the representation with a person the lawyer knows to be represented by another lawyer in the matter, unless the lawyer has the consent of the other lawyer or is authorized to do so by law or a court order.

APPENDIX G

SCR 3.130(4.3) Dealing with unrepresented person

In dealing on behalf of a client with a person who is not represented by counsel, a lawyer shall not state or imply that the lawyer is disinterested. When the lawyer knows or reasonably should know that the unrepresented person misunderstands the lawyer's role in the matter, the lawyer shall make reasonable efforts to correct the misunderstanding. The lawyer shall not give legal advice to an unrepresented person. The lawyer may suggest that the unrepresented person secure counsel.

APPENDIX H

762 F.3d 529 (2014)

Roslyn CURRIER, Plaintiff-Appellant,

v.

FIRST RESOLUTION INVESTMENT CORP., Defendant-Appellee.

No. 13-5943.

United States Court of Appeals, Sixth Circuit.

Argued: March 13, 2014.
Decided and Filed: August 8, 2014.

532*532 ARGUED: James Hays Lawson, Lawson at Law, PLLC, Louisville, Kentucky, for Appellant. John R. Tarter, Mapother & Mapother, P.S.C., Louisville, Kentucky, for Appellee. ON BRIEF: James Hays Lawson, Lawson at Law, PLLC, Louisville, Kentucky, James R. McKenzie, James R. McKenzie Attorney, PLLC, Louisville, Kentucky for Appellant. John R. Tarter, Mapother & Mapother, P.S.C., Louisville, Kentucky, for Appellee.

Before: GRIFFIN, WHITE, and STRANCH, Circuit Judges.

OPINION

STRANCH, Circuit Judge.

The Fair Debt Collection Practices Act (FDCPA) was enacted to prevent a wide array of unfair, harassing, deceptive, and unscrupulous collection practices by debt collectors. First Resolution Investment Corp. filed a notice of judgment lien against Roslyn Currier's home and maintained it for approximately one month although the judgment it was based on never became final and was vacated. We hold that filing and failing to release an invalid judgment lien against a debtor's home while the related state court collection action remains pending falls within the broad scope of practices prohibited by the FDCPA. Because Currier stated a plausible claim under the FDCPA, we REVERSE the dismissal of her claims and REMAND for further proceedings.

I. FACTS AND PROCEEDINGS

We begin by accepting as true the facts alleged in the Complaint. In May 2012, First Resolution, a debt collector, brought an action in Kentucky state court against Currier to collect a charged-off credit card debt of $1,000.51 plus 24% per annum interest for over six years, to be charged "until paid." After Currier's pre-arranged local counsel failed to appear at a hearing on October 1, 2012, the Kentucky court issued a default judgment against Currier. On October 5, Currier filed a motion to vacate the default judgment and for an enlargement of time to file her Answer, alleging that she had a complete statute of limitations defense.[1] As of that date, the judgment against Currier was not final under Kentucky law. *See* Gullion v. Gullion, 163 S.W.3d 888, 891 (Ky.2005) (noting that a motion to vacate a judgment stays finality until the motion is ruled upon).

On October 8, First Resolution filed a judgment lien against Currier's home. This lien was invalid because, under Kentucky law, a judgment lien can arise only from a final judgment. *See* Ky.Rev.Stat. Ann. § 426.720(1); *Laferty v. Wickes Lumber Co.*, 708 S.W.2d 107, 108 (Ky.Ct. App.1986) (noting that failure to strictly follow statutory requirements renders a lien invalid). A Kentucky judge held a hearing on October 29 and ruled from the bench that it would grant Currier's motion to vacate the default judgment. Although the lien had been invalid since October 5 and First Resolution knew the underlying judgment would be entirely vacated, First Resolution did not release the lien until November 5.

Currier sued First Resolution in federal court, alleging that the invalid lien violated various provisions of the FDCPA, including the prohibitions against unfair debt collection practices, against collecting an unauthorized amount, and against threatening 533*533 to take an action that cannot legally be taken. *See* 15 U.S.C. §§ 1692f, 1692f(1), 1692e(5). Finding that a violation of state law is not a per se violation of the FDCPA and that the invalid lien was not a threat, the district court dismissed the claims. Currier appeals.

II. STANDARD OF REVIEW

We review de novo a district court order dismissing a complaint pursuant to Rule 12(b)(6). *Bridge v. Ocwen Fed. Bank, FSB*, 681 F.3d 355, 358 (6th Cir.2012). To survive a motion to dismiss, the plaintiff need only plead sufficient factual matter, which we must accept as true, to "state a claim to relief that is plausible on its face" meaning that we can draw the reasonable inference that the defendant is liable for the misconduct alleged. *Ashcroft v. Iqbal,* 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009) (internal quotation marks omitted). Rule 8(a)(2) requires only a "short and plain statement of the claim showing that the pleader is entitled to relief." Fed.R.Civ.P. 8(a)(2). Our analysis "rests primarily upon the allegations of the complaint, [but] matters of public record, orders, items appearing in the record of the case, and exhibits attached to the complaint also may be taken into account." *Henry v. Chesapeake Appalachia, L.L.C.,* 739 F.3d 909, 912 (6th Cir.2014) (internal quotation marks omitted).

III. ANALYSIS

Congress passed the FDCPA to address the widespread and serious national problem of debt collection abuse by unscrupulous debt collectors. *See* S.Rep. No. 95-382, at 2 (1977), 1977 U.S.C.C.A.N. 1695, 1696; *see also* 15 U.S.C. § 1692(a), (e). The Act prohibits a wide array of specific conduct, but it also prohibits, in general terms, any harassing, unfair, or deceptive debt collection practice, which enables "the courts, where appropriate, to proscribe other improper conduct which is not specifically addressed." S.Rep. No. 95-382, at 4, 1977 U.S.C.C.A.N. 1695, 1698;*see generally* 15 U.S.C. §§ 1692d-1692f. As we have explained in the past, the Act is "extraordinarily broad." *Barany-Snyder v. Weiner,* 539 F.3d 327, 333 (6th Cir. 2008) (quoting *Frey v. Gangwish,* 970 F.2d 1516, 1521 (6th Cir.1992)). To determine whether conduct fits within the broad scope of the FDCPA, the conduct is viewed through the eyes of the "least sophisticated consumer." *Id.* This standard recognizes that the FDCPA protects the gullible and the shrewd alike while simultaneously presuming a basic level of reasonableness and understanding on the part of the debtor, thus preventing liability for bizarre or idiosyncratic interpretations of debt collection notices. *Id.*

Currier alleges that filing and failing to release the invalid lien against her home violated multiple provisions of the FDCPA, "including, but not limited to": 15 U.S.C. § 1692f, which prohibits using "unfair or unconscionable means ... to collect any debt"; § 1692f(1), which prohibits the "collection of any amount ... unless such amount is expressly authorized by the agreement creating the debt or permitted by law"; and § 1692e(5), which prohibits "threat[ening] to take any action that cannot legally be taken or that is not intended to be taken." First Resolution admits, and the district court properly found, that Currier has alleged that: she is a "consumer" within the meaning of the Act; the debt arose for personal, family, or household purposes; and First Resolution is a "debt collector." *See* 15 U.S.C. §§ 1692(e), 1692a(3), 1692a(5)-(6). We conclude that Currier sufficiently alleged conduct that falls within the broad scope of practices prohibited by the FDCPA and turn now to the specific provisions alleged.

534*534 **1. Claims Under the FDCPA**

The FDCPA does not define an "unfair or unconscionable" practice under § 1692f, but, with the caveat that it is not limiting the general application of the term, it sets forth a non-exhaustive list of conduct that rises to that level. *See also* *Glazer v. Chase Home Fin. LLC,* 704 F.3d 453, 461-62 (6th Cir.2013); *Limited, Inc. v. C.I.R.*,286 F.3d 324, 332 (6th Cir.2002) (under the rule of noscitur a sociis, the court should view the undefined term in light of its associates). The listed conduct includes acceptance or solicitation of a postdated check absent certain circumstances, charging any person for communications by concealing the true purpose of the communication, taking or threatening to take an action to dispossess or disable property when there is no present right in the property, communicating with a consumer about a debt via postcard, or sending mail with any symbol other than the debt collector's address and non-identifying business name. 15 U.S.C. § 1692f. The term also includes the collection of any amount not expressly authorized by the debt agreement or by law. 15 U.S.C. § 1692f(1). Other actions that courts have determined to be potentially "unfair" under § 1692f include attaching law-firm generated documents resembling credit card statements to a state collection complaint, *Hartman v. Great Seneca Fin. Corp.*, 569 F.3d 606, 610, 614 (6th Cir. 2009), sending a collection letter that questioned the debtor's honesty and good intentions, *McMillan v. Collection Prof'l, Inc.*, 455 F.3d 754, 765 (7th Cir.2006), filing for a writ of garnishment against a debtor who was current in payments, *Fox v. Citicorp Credit Servs., Inc.*, 15 F.3d 1507, 1517 (9th Cir.1994), and collecting 33% of a debt balance as a collection fee, *Bradley v. Franklin Collection Servs.*, 739 F.3d 606, 610 (11th Cir.2014).

Unfair practices and deceptive practices are prohibited under separate sections of the Act. *See* 15 U.S.C. §§ 1692e (barring "false, deceptive, or misleading representations or means"), 1692f (barring "unfair or unconscionable means"); S.Rep. No. 95-382, at 4, 1977 U.S.C.C.A.N. 1695, 1698 ("[T]his bill prohibits in general terms any harassing, unfair, or deceptive collection practice."). Therefore, a collection practice could be unfair without necessarily being deceptive. *See* *Fed. Exp. Corp. v. U.S. Postal Serv.*, 151 F.3d

536, 542 (6th Cir. 1998) ("A statute should be construed to accord meaning and effect to each of its provisions.")

Drawing all reasonable inferences from the facts alleged, First Resolution filed an invalid judgment lien on October 8, when it should have known that Currier had filed a meritorious motion to vacate the default judgment on October 5, three days earlier. Though First Resolution admittedly knew of Currier's motion to vacate later on October 8, it did nothing to release the lien or correct the error. First Resolution admitted at oral argument that good and proper practice would be to correct such errors, but offered no explanation for its failure to do so. Several weeks later, when the state judge ruled from the bench that the judgment would be vacated, First Resolution *still* failed to release it. It had no arguable basis for holding a judgment lien at that point in time. First Resolution did not voluntarily release the invalid lien until seven days later.

This conduct was not a mere technical violation of Kentucky law. The judgment lien placed an improper legal burden on Currier's home, restricting her rights in her own property until First Resolution decided to release the lien or until Currier undertook the burden of filing an action to quiet title. *See, e.g., Tucker v. Grace Enters. of Ky., LLC,* No. 2003-CA-002341-MR, 535*535 2004 WL 2566518, at *1-2 (Ky.Ct. App. Nov. 12, 2004) (illustrating the use of a quiet title action to remove an improper judgment lien; noting that the lien prevented the conveyance of a marketable title in the property). The filing of and refusal to release an invalid lien is taken seriously in Kentucky; it can, in some circumstances, be a criminal offense or grounds for suspension of an attorney. Ky.Rev.Stat. Ann. § 434.155 (intentionally filing a groundless lien is a Class D felony); *Ky. Bar Ass'n v. Glide-well,* 348 S.W.3d 759, 761-63 (Ky.2011) (suspending attorney for repeatedly filing improper liens during divorce proceedings). Encumbering a debtor's home while the debtor pursues her legal rights to challenge the debt is not fair or equitable. The very point of a lien is that it coerces the property holder to settle a debt in order to maintain rights in the property. *See* "Lien," Black's law Dictionary (9th ed. 2009) (A lien is "[a] legal right of interest that a creditor has in another's property, lasting usu[ally] until a debt or duty that it secures is satisfied."). The least sophisticated consumer, indeed most consumers, would regard filing a lien on the debtor's home using a state procedure that does not authorize such action as an "unfair or unconscionable means to collect or attempt to collect" the debt. 15 U.S.C. § 1692f.

Maintaining an invalid lien against a debtor's home falls comfortably within the kinds of practices Congress has identified as unfair under § 1692f of the FDCPA. As First Resolution admitted at oral argument, the judgment lien exposed Currier to publicity and damaged her credit. This practice would cause at least as much improper public exposure as communicating with a consumer via post card or sending mail with a symbol other than the debt collector's address. *See* 15 U.S.C. § 1692f(7)-(8). Filing an invalid lien is also comparable to taking or threatening to take a nonjudicial action to effect the dispossession of property in which the debt collector has no enforceable security interest. *See* 15 U.S.C. § 1692f(6). Though invalid, the judgment lien appears valid on its face, thus representing to the least sophisticated consumer and the public that the creditor had a final judgment, had a right to execute on that judgment, and had a valid interest in the debtor's home. *See Hartman,* 569 F.3d at 613-14 (holding that where a jury could find that the least sophisticated consumer would be misled by a debt collection document, summary judgment for the defendant was improper under §§ 1692e and 1692f).

Currier has plausibly alleged an unfair debt collection practice under the broad meaning of § 1692f. Accordingly, it is unnecessary to go into the details of whether the practice is also unfair because it is an attempt to collect an amount not authorized by the credit card agreement or by law under § 1692f(1).

The alleged conduct of filing and maintaining an invalid lien for a month can also fairly be characterized as a threat to take an action that cannot legally be taken within the meaning of § 1692e(5). Court filings can be a threat under the FDCPA. *Gionis v. Javitch, Block, Rathbone, LLP,* 238 Fed.Appx. 24, 28-29, 30 (6th Cir.2007); *see also* *Sayyed v. Wolpoff & Abramson,* 485 F.3d 226, 229-32 (4th Cir.2007) (holding that the FDCPA applies to interrogatories and motions for summary judgment); *Gearing v. Check Brokerage Corp.,* 233 F.3d 469, 472-73 (7th Cir.2000) (holding that the FDCPA applies to a complaint). The fact that the threat appears in a lawsuit or other court filing does not diminish the threatening nature of the communication for purposes of the FDCPA. *See Gionis,* 238 Fed.Appx. at 29-30. Nor does it matter that the filing 536*536 is also an "action" because "`attempts' and `threats' are not necessarily mutually exclusive concepts." *Id.* at 28-29. In light of the Act's overarching purpose to prevent false, deceptive, or misleading representations, whether a filing's "metaphysical description is more an `attempt' [to collect a debt] or more a `threat' is essentially wordplay. No semantical recasting alters the intimidating effect on the least sophisticated consumer: that she would be confused, and reasonably might feel pressured to immediately pay the debt, even if she disputed its validity" in order to avoid the implied consequences of the lien. *Id.* at 29 (internal quotation marks omitted). "This is so because even if the least sophisticated consumer," or indeed*any* consumer, "would view [the lien] as an actual `attempt' to collect [the debt], the attempts would nonetheless embody an ongoing threat" that First Resolution would force the sale of her home or refuse to voluntarily release the lien. *Id.*; *see also*Ky.Rev. Stat. Ann. §§ 426.010, 426.290 (giving debt collector who holds a judgment lien a right to force the sale of underlying property). Currier plausibly alleged a claim under § 1692e(5).

It must be remembered that the Act prohibits "in general terms" harassing, unfair, or deceptive collection practices. S.Rep. No. 95-382, at 4, 1977 U.S.C.C.A.N. 1695, 1698. While "misleading" practices under § 1692e and "unfair" practices under § 1692f reference separate categories of prohibited conduct, they are broad, potentially overlapping, and are not mutually exclusive. A debt collector's action could be "misleading" under § 1692e, "unfair" under § 1692f, or, as alleged here, both. The distinct characteristics of § 1692e and § 1692f can also inform one another. The example of a "misleading" practice in § 1692e(5) — a threat to take an illegal action — supports Currier's theory that actually taking the illegal action is also an "unfair" practice under § 1692f. It is unlikely that Congress prohibited a threat to do something illegal but did not prohibit the additional step of taking that illegal action. Ultimately, the legislative decision to prohibit broad categories of behavior — defined by examples — suggests that the Act should be read as a whole and in light of its purpose.

We do not reach the arguments Currier makes for the first time on appeal that the invalid lien was also a violation of § 1692e(2)(A), which prohibits false representation of the legal status of a debt; § 1692e(4), which prohibits representing that nonpayment of a debt could result in the sale of property when sale is not authorized by law; and § 1692e(10), which prohibits using deceptive means to attempt to collect a debt. These are matters to be addressed in the first instance by the district court.

2. Defenses Raised to the FDCPA Claims

First Resolution raises a defense to the FDCPA claims — that the invalid lien was not a violation of the FDCPA because a violation of state law is not a per se violation of the FDCPA. Our sister circuits have indeed concluded — usually in the context of licensing violations — that not every technical violation of state debt collection law rises to the level of unfair or otherwise prohibited conduct under the FDCPA. *See, e.g.,* *LeBlanc v.*

Unifund CCR Partners, 601 F.3d 1185, 1192 (11th Cir.2010) (holding that debt collector's failure to have a proper license, a violation of state law, is not a per se violation of the FDCPA but that it may *support* a violation of the FDCPA);Carlson v. First Revenue Assurance, 359 F.3d 1015, 1018 (8th Cir.2004) (holding that a debt collector's failure to have the proper license was not the kind of "false or misleading" practice barred by 537*537 § 1692e); *Wade v. Reg'l Credit Ass'n*, 87 F.3d 1098, 1100-01 (9th Cir.1996) (holding that sending a debtor correct notice of debt and risks to her credit was not a violation of the FDCPA even though debt collector was not licensed in debtor's state). A sister circuit has also rejected the contention that using the proper state procedure to freeze a debtor's bank account after receiving a valid final judgment was unfair under § 1692f where the debt collector unknowingly froze an account that contained exempt funds. *Beler v. Blatt, Hasenmiller; Leibsker, & Moore, LLC,* 480 F.3d 470, 472, 473-74 (7th Cir. 2007). There, the court said that the FDCPA is not an enforcement mechanism for state laws and it declined to create a hearing requirement in the state system. *Id.* at 473-74.

We agree that Congress did not turn every violation of state law into a violation of the FDCPA. But that does not mean that a violation of state law can never *also* be a violation of the FDCPA. The proper question in the context of an FDCPA claim is whether the plaintiff alleged an action that falls within the broad range of conduct prohibited by the Act. The legality of the action taken under state law may be relevant, as it is in this case. *See* LeBlanc, 601 F.3d at 1192 (considering the state law violation relevant to the FDCPA analysis). If the judgment lien had been valid under state law for the month that First Resolution held it, we could not say that it was an unfair debt collection practice even though it was coercive in nature. But the same action becomes unfair when accomplished by using a state mechanism that does not authorize it.

First Resolution also argues that it cannot be held liable under the FDCPA because it did not have reason to know that the lien was invalid at the time it mailed the notice of judgment lien. According to this version of events, the normal rule that a successful plaintiff in Kentucky court must wait 10 days to execute on a judgment did not apply here because the default judgment stated that "[t]his is a final judgment" and "execution may issue forthwith." *See* Ky.Rev.Stat. Ann. § 426.030 (setting a waiting period "unless ordered by the court"). Although the motion to vacate unquestionably rendered the judgment non-final, First Resolution contends that it did not know about the motion until the end of the day on October 8, 2012, after it had already mailed the notice of judgment lien. *See* Pers. Bd. v. Heck, 725 S.W.2d 13, 18 (Ky.Ct.App. 1986)("A motion [to vacate a judgment] converts a final judgment to an interlocutory judgment.").

This argument fails for two reasons. First, whether or not First Resolution had reason to believe that the lien was valid when filed is an issue of fact that is not relevant at the motion to dismiss stage. Second, even if First Resolution's version of the facts were construed to be part of a bona fide error defense, we note that it would not establish all the elements of such defense. *See* 15 U.S.C. § 1692k(c); *Hartman*, 569 F.3d at 614. To qualify for this defense, a debt collector must prove by a preponderance of the evidence that the violation was unintentional, that it was the result of a bona fide error, and that the debt collector maintained procedures to avoid the error. *Hartman*, 569 F.3d at 614. Although First Resolution alleges that the invalid lien *began* as an unintentional bona fide error, it admits that it learned of Currier's motion to vacate the judgment on the same day it filed the judgment lien and nonetheless failed to release the lien for a month. And it has alleged nothing to show that it maintains a procedure to avoid the error. In Kentucky, 538*538 a losing party has only 10 days after entry of the final judgment to file a motion to vacate the judgment. Ky. R. Civ. P. 59.05. The error at issue could have been avoided if First Resolution had established a practice of waiting to file a judgment lien until 10 days after obtaining a judgment or of checking the docket before filing a lien. It could also have maintained a procedure for immediate correction of error. But First Resolution admits that it had implemented none of these procedures. First Resolution is not entitled to the bona fide error defense.

IV. CONCLUSION

For the reasons explained above, we REVERSE the district court's dismissal of Currier's complaint and REMAND the case for further proceedings consistent with this opinion.

[1] The Complaint includes what appears to be a typo that says the motion to vacate the default judgment was filed on September 19, but the Defendant admits that the motion was filed on October 5, 2012.?

APPENDIX I

813 S.W.2d 287 (1991)

CAPITOL CADILLAC OLDS, INC., Appellant/Cross-Appellee,
v.
Gary H. ROBERTS and Angie Roberts, Appellees/Cross-Appellants.

Nos. 89-SC-367-DG, 89-SC-862-DG.

Supreme Court of Kentucky.

June 6, 1991.
As Modified on Grant of Rehearing August 29, 1991.

288*288 H. Foster Pettit, William B. Owsley, Wyatt, Tarrant & Combs, Lexington, for appellant/cross-appellee.

William P. Sturm, Frankfort, for appellees/cross-appellants.

M. Brooks Senn, M. Thurman Senn, Senn, Miller & Smith, David C. Pottinger, John T. McGarvey, Rebecca A. Clark, Morgan & Pottinger, P.S.C., Louisville, for amicus curiae.

LAMBERT, Justice.

This Court granted the motion of appellant, Capitol Cadillac Olds, Inc. (CCO) for discretionary review and the cross-motion for discretionary review of appellees, Gary H. Roberts and Angie Roberts. A number of issues have been raised with regard to the law of sales as it applies to new automobiles and the law relating to commercial financing and allowable recoveries upon default. We have been favored with *amicus curiae* briefs which argue particular phases of the case.

This saga began in January of 1985 when the Robertses purchased a new Oldsmobile Calais. Shortly after the purchase they discovered that when the car was stopped on a steep incline and the transmission placed in park, a grinding metal on metal sound could be heard. During the ensuing six months, on three separate occasions, the car was returned to CCO for repair of this problem and all such efforts were unsuccessful.

During the time the Robertses were in possession of the car and while it was in the CCO shop for routine maintenance, a light fixture fell on the front of the car and scarred the finish. Thereafter, CCO made five unsuccessful attempts to repaint the car to appellees' satisfaction.

On July 3, 1985, appellees returned the car to CCO, tendered their written revocation of acceptance, and demanded recision of the contract.

The Robertses filed suit against CCO, General Motors, and the bank to which the "with recourse" retail installment contract and security agreement had been assigned. They alleged breach of warranty, revocation of acceptance, and negligence. All defendants answered denying liability and the bank brought a counterclaim against the Robertses and a cross-claim against CCO for the amount of the note. Summary judgment was entered for the bank against CCO for the amount due plus interest at the contract rate and attorneys' fees of $900. No judgment in favor of the bank was entered against the Robertses as CCO paid the bank's judgment.

The trial court granted CCO and General Motors summary judgment on the revocation of acceptance claim and the breach of warranty claim. By amended complaint, the Robertses sought recovery against CCO of the amount they had paid the bank prior to their attempted revocation of acceptance, alleged that the retail installment contract was usurious and alleged that CCO had improperly used the car while it was in its custody by driving it hundreds of miles. A claim was also asserted under the Consumer Protection Act and punitive damages were demanded. General Motors and CCO were granted summary judgment on the amended complaint.

The only issue which went to trial was the Robertses' negligence claim against CCO which arose as a result of the fallen light fixture. When the evidence was heard by the jury, a verdict was returned in favor of the Robertses in the amount of $925 on the claim of negligence in damaging 289*289 the car and failure to successfully repair the body damage. In the same order, the trial court determined that CCO should recover of the Robertses the amount due on the retail installment contract, the $900 attorney fee it had been required to pay the bank, plus interest at the contract rate on the entire amount until satisfaction of the judgment and its attorney fee of $2,000. The remainder of the Robertses' claims were dismissed and a final judgment entered.

On appeal to the Court of Appeals, the Robertses raised a number of issues and that Court affirmed in part and reversed in part. This Court has carefully reviewed the opinion of the Court of Appeals and determined that it is unnecessary to address each and every issue decided by that Court and raised by the parties on this appeal and cross-appeal. We will limit our decision to those issues which are of substantial public interest or necessary for an appropriate resolution of the controversy. Except as expressly modified herein, the decision of the Court of Appeals is affirmed.

The first issue we will review is the Court of Appeals' reversal of the summary judgment in favor of CCO and against appellees on their revocation of acceptance claim. This Court has recently addressed the standard by which motions for summary judgment are to be measured in *Steelvest v. Scansteel*, Ky., 807 S.W.2d 476 (1991), and reaffirmed our previous view that such motions should not be granted unless it appears to be impossible for the party against whom the motion is made to produce evidence at trial which would warrant a judgment in his favor.*Paintsville Hospital v. Rose*, Ky., 683 S.W.2d 255 (1985). When the facts or the reasonable inferences to be drawn from those facts are in dispute, summary judgment is improper and the issue should be tried.

Revocation of acceptance is a remedy contained in the Uniform Commercial Code to be utilized when the nonconformity of the goods is substantial and impairs its value to the buyer. KRS 355.2-608. Revocation of acceptance may be predicated upon discovery of a latent defect, as in this case, and must occur within a reasonable time after the purchaser discovered or should have discovered the grounds for it. The statute contains an element of subjectivity by focusing on whether the nonconformity "substantially impairs its value to him."

"However, it is said the test of impaired value is a subjective one which must be evaluated by objective standards. Furthermore, the question of whether a defect substantially impairs the value of an automobile is a question of fact to be determined by a jury." R. Billings, *Handling Automobile Warranty and Repossession Cases,* § 522 (1984).

"The substantial impairment test is subjective in that the needs and circumstances of the buyer must be examined. The buyer's personal belief as to the reduced value of the automobile is not determinative. However, the trier of fact must make an objective determination that the value of the goods to the particular buyer, and not the average buyer, has in fact been substantially impaired." *Id.* at § 5.23.

It is undisputed by the parties that the grinding noise did exist and that the Robertses gave timely notice of their election to revoke their acceptance. The only question is whether the grinding noise which occurred only in unusual circumstances substantially impaired the value of the new automobile to the purchaser of it. While the underlying facts are not seriously disputed, the inferences to be drawn therefrom are disputed matters. CCO contends that the grinding noise was nothing more than an annoyance. The Robertses contend, on the other hand, that it caused them to be apprehensive about their safety while driving the car and apprehensive about the durability of the car.

The seminal Kentucky decision which addresses the right of the purchaser of an automobile to revoke his acceptance is *Ford Motor Company v. Mayes*, Ky.App., 575 S.W.2d 480 (1979). In the *Mayes* decision, the Court of Appeals quoted with approval from *Zabriskie Chevrolet, Inc. v.* 290*290 *Smith*, 99 N.J.Super. 441, 240 A.2d 195, 205 (1968), as follows:

"For a majority of people the purchase of a new car is a major investment, rationalized by the peace of mind that flows from its dependability and safety. Once their faith is shaken, the vehicle loses not only its real value in their eyes, but becomes an instrument whose integrity is substantially impaired and whose operation is fraught with apprehension."

Each year vendors of automobiles spend millions of dollars to persuade potential customers to purchase their products. Customers are told that if they purchase a particular brand or type of vehicle they will achieve newfound happiness and peace of mind in the knowledge that their vehicle is of superior quality, safety and styling. Great expectations are created and reinforced to persuade the customer to part with his money to make the purchase. In view of this, it is not unreasonable to require the vendor to deliver all or substantially all of that which has been promised.

We conclude that whether the grinding noise substantially impaired the value of the vehicle to the Robertses was an issue of fact which should have been determined by the trier of fact. On this issue we affirm the Court of Appeals.

Our decision on the revocation question resolves one of the issues raised by the Robertses in their cross-appeal: whether CCO improperly used the car by driving it hundreds of miles after redelivery by the Robertses. The Court of Appeals succinctly and accurately stated "If the jury had found that revocation was proper, then CCO's use of its own vehicle was not improper. If the jury had found that revocation was improper, then CCO improperly used the appellants' vehicle" and compensation would be required.

At the time the automobile was sold, appellee, Gary H. Roberts, signed an instrument denominated "Dealer Warranty Disclaimer" in which CCO purported to sell the vehicle "as is" and "with all faults." Appellee, Angie Roberts, did not sign this instrument. CCO insists on enforcement of the Disclaimer and asserts that it made no express warranties and disclaimed any implied warranties.

First, it is clear that this writing has no applicability to General Motors as it is in favor of only the automobile dealer, CCO. Thus appellees' warranty claim against General Motors for breach of its express warranty and any implied warranties which may exist is unaffected by the Disclaimer and the Court of Appeals correctly held that summary judgment in favor of General Motors on the breach of warranty claim was improper. *Volvo of America Corp. v. Wells,* Ky.App., 551 S.W.2d 826 (1977). We need not determine whether the Dealer Warranty Disclaimer was effective against appellee, Gary H. Roberts, since it appears that throughout this litigation the Robertses have not contested the validity or enforceability of this instrument. Therefore, the Robertses are without any claim against CCO for breach of implied warranties. We hasten to add, however, that on the facts presented here, revocation of acceptance and damages for breach of warranty are mutually exclusive remedies. Only if the Robertses are unsuccessful in their claim for revocation of acceptance, a matter unaffected by the warranty disclaimer, will it be necessary to determine whether General Motors breached its warranties. R. Billings, *Handling Automobile Warranty and Repossession Cases, supra,* § 520 (1984).

CCO next contends that the Court of Appeals erred in reversing the trial court's summary judgment dismissing the Robertses' Consumer Protection Act claim. KRS 367.170 and KRS 367.220. This claim was asserted by amended complaint and arose out of the events which followed the accidental damage to the car while it was in the CCO repair shop.

At the outset, it should be remembered that the damage to the finish of the automobile was as the result of simple negligence. There is no allegation of intentional or malicious conduct on the part of CCO in damaging the automobile. Thus, at the time the car was damaged by the fallen light fixture, the Robertses were entitled to compensation for the damage and nothing 291*291 more. As an entirely independent transaction, although it may not have been recognized by the parties as such, a separate contract was entered into between CCO and the Robertses for repair of the damage. Neither party was compelled to enter into the contract, but both did so willingly. Thereafter, CCO repainted the car four times in-house and on a fifth occasion had it repainted by an outside body shop. The Robertses were never satisfied with the quality of the work.

As best we can determine, the Robertses' Consumer Protection Act claim is predicated on the view that CCO failed to competently repair the damage, but attempted to persuade them that the work was done properly, and that at some point CCO attempted to deceive them as to whether or not "factory" paint had been used. The parties' repair contract was for completed performance and CCO, as the party charged with performance, was entitled to use its skill and judgment as to the method and materials. Whether the performance rendered was satisfactory (whether the paint matched and the finish was smooth) is a matter about which reasonable people might disagree. CCO may have insisted that its performance was satisfactory, but clearly the Robertses did not accept this view. If there was any attempted deception, it was unsuccessful as the Robertses asserted a claim for damages and recovered $925. The recovery of this sum on the negligence claim against CCO represented full compensation as determined by the jury for the damage to the automobile and the shoddy repair work.

Not every failure to perform a contract is sufficient to trigger application of the Consumer Protection Act. The statute requires some evidence of "unfair, false, misleading or deceptive acts" and does not apply to simple incompetent performance of contractual duties unless some element of intentional or grossly negligent conduct is also present. *Dare to Be Great, Inc. v. Commonwealth, ex rel. Hancock,* Ky., 511 S.W.2d 224 (1974). There is an analogy between the Consumer Protection Act claim asserted here and a tort claim for bad faith based on an insurer's failure to pay the amount due its policyholder. In *Feathers v. State Farm Fire and Casualty Co.*,Ky.App., 667 S.W.2d 693 (1983), the validity of which was recently reaffirmed in*Curry v. Fireman's Fund Ins. Co.*, 784 S.W.2d 176 (1989), the Court of Appeals said:

"[T]he allegations [of the complaint] show substantial wrongs committed against a clearly protected interest and rights. We are not talking about bad manners or mere breakdowns in communications resulting in irritations injuring pride." *Feathers* at 696.

In this case, we believe the acts complained of fall short of "substantial wrongs" and more nearly amount to "irritations injuring pride." On this issue we reverse the Court of Appeals.

Our view with regard to the Consumer Protection Act is likewise dispositive of the Robertses' claim of entitlement to an instruction authorizing the award of punitive damages for negligence in the painting of the car. Relying on this Court's decision in*Horton v. Union Light, Heat & Power Co.*, Ky., 690 S.W.2d 382 (1985), the Robertses contend the jury should have been authorized to award punitive damages. This case bears little, if any, resemblance to *Horton.* In our view, while a combination of CCO's negligence in permitting the light fixture to damage the car and its failure to properly repair the car was sufficient to justify the award of compensatory damages, the evidence was woefully insufficient to justify punitive damages.

We now turn to perhaps the most significant issue in this case: whether the interest on the judgment against the Robertses was correctly or incorrectly calculated.

It should be recalled that the Franklin Circuit Court entered summary judgment in favor of CCO against the Robertses. The judgment was for the amount due under the contract plus interest at the contract rate, 15.5%, from the date the bank accelerated the debt. On appeal, the Court of Appeals reversed the trial court and held that "judgment on notes that become due by reason of acceleration cannot bear interest beyond the time when the note became 292*292 due and payable by reason of acceleration." Thus, the Court of Appeals held that during that period of time between acceleration of the indebtedness by reason of default and the date on which judgment is entered, no interest may accrue upon the indebtedness.

Both parties and the courts below rely upon this Court's decisions in *Duff v. Bank of Louisville & Trust Company*, Ky., 705 S.W.2d 920 (1986), and *Credit Alliance Corp. v. Adams Construction Corp.*, Ky., 570 S.W.2d 283 (1978). As it applies to this case,*Credit Alliance* stands for the proposition that a creditor may not declare a debt accelerated and also collect pre-computed but unaccrued interest and finance charges. The *Duff* case goes a step further with a statement upon which the Robertses rely as follows: "[O]n notes accelerated by a bank, *it cannot collect interest* beyond the time when the note became due and payable by reason of the acceleration." (Emphasis added.) *Duff* at 925. The authority cited for this proposition is *Credit Alliance Corp. v. Adams Construction Corp.*, *supra,* but as stated before, *Credit Alliance* merely precludes collection of pre-computed but unaccrued interest and finance charges, and there is nothing which required the court to go further in *Duff.* Moreover, the statement quoted from *Duff* is ambiguous. It fails to disclose whether the "interest" referred to is "pre-computed" interest or "any" interest, and we must determine which it is.

We are of the opinion that a creditor who accelerates an indebtedness by reason of a default should not be deprived of interest which would otherwise accrue during the time between acceleration of the debt and entry of judgment. The law is clear that a creditor is entitled to interest at the contract rate from the date of judgment until it is paid, KRS 360.040, and it is equally clear that interest accrues in accordance with the contract until the date of acceleration. We can think of no rational reason to exclude the period between the date of acceleration and the date of judgment for the accrual of interest. To avoid misunderstanding and recognizing our limitations when using the arcane language of the world of finance, we simply say that a creditor may include in its computation of the amount due *only* such interest as has been earned and actually accrued as of the date of acceleration. However, at the time judgment is entered, the court may award the amount due as of the date of acceleration plus interest at the contract rate from the date of acceleration until paid. The Court of Appeals erred in its resolution of this issue.

The final issue we must decide is whether the contractual attorney fee award should be based on the amount due when the debt was accelerated or the amount due when the judgment was entered. This issue is closely related to, but not necessarily controlled by, whether prejudgment interest is allowed during the period between debt acceleration and entry of judgment. Having determined that such prejudgment interest is allowable, we must also determine whether it is includable in the amount upon which the attorney fee is computed.

The retail installment contract signed by the Robertses contained a provision whereby they agreed to pay a reasonable attorney fee. It was further agreed "that a reasonable attorney fee shall be an amount equal to fifteen percent (15%) of the amount due and payable under the contract." The statutory provision which governs attorney fees in motor vehicle retail installment contracts, KRS 190.100(1)(d), states that: "[T]he retail instalment contract may provide for the payment of attorneys' fees not exceeding fifteen percent (15%) of the amount due and payable under such contract. . . ." Both the contract and the statute utilize the same language to define the amount upon which the attorney fee may be computed.

CCO has cited persuasive Kentucky authority for the proposition that "due and payable" should be interpreted to include amounts presently owed and amounts which may be owed in the future. *Griffith v. Speaks,* 111 Ky. 149, 63 S.W. 465 (1901), *Department of Public Welfare v. Allen,* 255 Ky. 301, 74 S.W.2d 329 (1934),and *Warner v. Lexington Roller Mills, Inc.,* 293*293 314 Ky. 1, 233 S.W.2d 988 (1950). This definition is consistent with the common usage of the terms and we can think of no reason to depart from it. For a more fundamental reason, however, we consider it appropriate to construe the statute in a manner which will not deprive the trial court of the discretion allowed by the statute.

It should never be overlooked that any award of an attorney fee is subject to a determination of reasonableness by the trial court. *Duff, supra.* In many cases it would be unreasonable to allow the agreed-upon maximum whether or not the amount due includes prejudgment interest. In simple cases in which the debtor makes little or no defense and in default judgment cases where the time and skill required is minimal, to award the maximum may result in a windfall and constitute an abuse of discretion. In more difficult cases, however, and with due regard for the provisions of SCR 3.130 (Rule 1.5), the allowance of a maximum fee based on the amount due on the date of acceleration plus prejudgment interest may be appropriate. The trial judge is generally in the best position to consider all relevant factors and require proof of reasonableness from parties moving for allowance of attorney fees. In exercising its discretion, a trial court should require parties seeking attorney fees to demonstrate that the amount sought is not excessive and accurately reflects the reasonable value of bona fide legal expenses incurred.

In the instant case, the trial court allowed an attorney fee of $2,000 based on a contested judgment of $13,907.74. On the surface, this would not appear to be improper based upon the contract, the statute, and a reasonable exercise of the trial court's discretion. The trial court erred, however, when it included in the judgment amount the sum of $900 in attorney fees previously awarded in favor of State Bank against CCO after CCO had refused to repurchase the "with recourse" retail installment agreement it had assigned to the bank. The "with recourse" assignment from CCO to State Bank was entirely separate from the dispute between the Robertses and CCO. As such, the Robertses should not be required to pay the attorney fee occasioned by CCO's refusal to perform under its contract.

To summarize this issue, we reverse that portion of the Court of Appeals' opinion which limits recovery of attorney fees to a sum based upon the amount due on the date of acceleration. On remand, the trial court may, in the exercise of its sound discretion, include for the purpose of computing the amount of attorney fees the entire amount of the judgment including prejudgment interest. Of course, the judgment should be corrected to exclude the $900 attorney fee incurred by CCO.

Upon remand, if this case is tried and results in a verdict for the Robertses on their revocation of acceptance claim, a number of the issues addressed herein will be rendered moot. If they prevail, the Robertses will be entitled to judgment for reimbursement of all sums they paid toward the purchase of the vehicle plus interest thereon at the rate applicable to judgments from date of each payment until the day they get their money, and to whatever further incidental and consequential damages are provided for by law in the Kentucky Uniform Commercial Code. If the Robertses do not prevail on their revocation of acceptance claim, damages may be awarded against General Motors for breach of warranty if the evidence justifies such an award and the jury so finds. If the Robertses fail to prevail on either of these claims, they will be liable to CCO for the amount due under the contract plus interest and attorney fees as we have directed computation thereof less the amount received by CCO when it resold the vehicle. Proof should be required as to the amount received by CCO upon resale, the date the proceeds were received, and such sum should be credited against the amount owed by the Robertses, and interest on that amount would not thereafter accrue.

This cause is remanded to the trial court for further proceedings not inconsistent herewith.

294*294 STEPHENS, C.J., LEIBSON, REYNOLDS and SPAIN, JJ., and FRANCIS D. BURKE, Special Justice, concur.

WINTERSHEIMER, J., dissents by separate opinion.

WINTERSHEIMER, Justice dissenting.

I respectfully dissent from that part of the majority opinion which relates to calculation of interest on the judgment and from the application of the Consumer Protection Act.

This unfortunate series of events began on the very first day the Robertses purchased their new 1985 Oldsmobile Calais on January 15, 1985, when they noticed a grinding noise coming from the front of the automobile. The dispute between the parties has continued to this very day.

The circuit court entered a summary judgment in favor of Capitol Cadillac and General Motors. The Robertses were ordered to pay $13,907.74, the amount due under the Retail Installment Contract, plus 15.5 percent annual interest until satisfied, and $2,000 for Capitol's attorneys fees.

From a technical and legal aspect, the most important issue is whether a creditor who accelerates a loan with precomputed interest is entitled to prejudgment interest from the date the debt is due until the date of judgment. On that question I believe the Court of Appeals was correct in the reasoning it applied to the calculation of interest on the judgment. During the period of time between the acceleration of the indebtedness by reason of default and the date on which judgment was entered, no interest should accrue on the indebtedness. *Cf.* *Duff v. Bank of Louisville & Trust Co.*, Ky., 705 S.W.2d 920 (1986), citing *Credit Alliance Corp. v. Adams Construction Corp.*, Ky., 570 S.W.2d 283 (1978). Accordingly, the most Capitol could obtain is a judgment that included the interest accrued up to the time of acceleration. Such a judgment would have interest at the rate of 15.5 percent per annum as stated in the note. KRS 360.040.

From the point of view of the Consumer Protection Law, the most important issue is the use of the Consumer Protection Act in this situation. The Robertses did receive a verdict for the negligent repainting claim in the amount of $925, but the circuit judge refused to give a punitive damage instruction.

The Court of Appeals correctly determined that the amended complaint of the Robertses raised the issue that GM and Capitol violated the Consumer Protection Act, KRS Chapter 367. The Robertses sought punitive damages from Capitol, and sufficient evidence of unfair and unconscionable trade practices was present to make summary judgment on this claim improper.

ADVISORY ETHICS OPINION 87-18

SYNOPSIS:

An attorney is disqualified from representing a mortagee in a foreclosure action when he represented the mortgagor in the subject property's purchase. This disqualification extends to the attorney's law firm and may not be waived by the clients' consent.

FACTS:

Attorney A and his firm frequently represent local banks/mortgagees in foreclosure actions. They also represent clients who purchase property in the same transaction in which mortgages are created. After representation in the purchase transactions, they do not represent the mortgagors any further. They then receive a request from a bank/mortgagee to initiate a foreclosure action against a mortgagor who is a former client.

DISCUSSION:

D.R. 5-105(A) prohibits an attorney's acceptance of proffered legal employment "if it would be likely to involve him in representing differing interests." The term "'differing interests' include[s] every 'interest that will adversely affect either the judgment or loyalty of a lawyer to a client, whether it be conflicting, inconsistent, diverse, or other interest."[1]

In the case presented for review, Attorney A owed and continues to owe a duty of loyalty to the mortgagor. During the purchase transaction, Attorney A advocated the mortgagor's position, a position which was adverse to the mortgagee. This adversity of interest and Attorney A's duty of loyalty remain after the mortgage is executed and a dispute over its effect arises. Thus, switching sides in a midstream battle between the mortgagor and mortgagee fits squarely within the prohibition of D.R. 5-105(A).[2] ("[H]aving represented a party to a transaction, a lawyer may not thereafter represent the other party in an action against his former client arising out of or closely related to the transaction.")

Because Attorney A is disqualified under D.R. 5-105(A), moreover, "no partner, or associate, or an other lawyer affiliated with him or his firm" may represent the bank/mortgagee. D.R. 5-105(D). This is a situation where the prohibition of employment is "firmwide."

Finally, the "waiver of conflict" provisions of D.R. 5-105(C) cannot lift the prohibition from Attorney A and his firm. In some cases, clients may consent to joint representation. Detailed and full disclosure is a prerequisite to such consent. In addition, however, the 5-105(A) situation creating the conflict must be one in which "it is obvious that [the attorney] can adequately represent the interest of each [client]." D.R. 5-105(C). Here, Attorney A cannot adequately represent both interests; loyalty to both the mortgagor and the mortgagee in a foreclosure action is impossible. Furthermore, if it were possible, the adequacy of such representation is far from obvious. The proffered employment from a bank/mortgagee when Attorney A or his firm represented the mortgagor in the purchase/mortgage transaction, therefore, is prohibited.

[1] Vermont Code of Professional Responsibility Definitions §1.
[2] *See* ABA Informal Opinion 1322 (1975).

APPENDIX K

PROFESSIONAL ETHICS OF THE FLORIDA BAR

OPINION 71-18
June 21, 1971

An attorney may represent a current client against a former client if the current matter is unrelated to the prior matters and if no confidences material to the current representation obtained in the prior representation. The mere fact that a bank's attorney's fee for handling a loan transaction was charged to the borrower does not preclude the bank's attorney from representing the bank in a subsequent suit on the promissory note.

CPR: DR 5-107

Chairman Massey stated the opinion of the committee:

An inquiring attorney represents a commercial bank which has litigation against an individual and corporations of which the individual is either stockholder, officer, director, or general manager. The litigation involves promissory notes and security agreements drafted by the inquirer's law firm but for which the fee was an expense paid by the borrower. As to the corporate obligations, the individual executed guarantees in connection therewith. One corporation is involved because it is alleged to be the alter ego of a borrowing corporation although it is not an obligor on the note.

Opposing counsel in this litigation raised a question as to the propriety of the inquirer representing the bank. It now appears the individual and at least one of the corporations are bankrupt and the bank desires the inquirer to hotly pursue the matter in bankruptcy court. The inquirer apparently did handle certain transactions which were related to the individual, but said transactions were limited and unrelated to matters involved in the mentioned litigation. The other transactions were review and negotiation of three leases for an entirely separate corporation; making effort to purchase some property for the separate corporation; referring a personal injury case involving the individual's son; and defending a separate corporation on a breach of lease suit. There apparently was no knowledge given or available (nor involved in the named representations) to the inquirer or his firm which would adversely affect the individual or the corporate defendants of the bank litigation. Communication in writing has been addressed to the inquirer by the individual objecting to his representation of the bank.

The inquirer's concern extends beyond the immediate problem to those loan transactions his firm handles for the bank which later result in litigation when the fee has been charged to the borrower, as is the normal course of business procedure.

Assuming the non-acquisition of confidential information in the other specified representations, which information would be material to the existing litigation, there is no conflict or impropriety in the inquirer's conduct in behalf of the bank in the existing litigation and bankruptcy proceedings. Beyond this, if there has been no relation between the inquirer and a proposed defendant in a promissory note suit or like litigation excepting the payment of the fee by the borrower-defendant, there is absolutely no conflict or impropriety involved. Such proposed representation does not contravene DR 5-107 or the ethical considerations applicable thereto.

[Revised: 08-24-2011]

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