



THE LEGAL LEAGUE QUARTERLY

COMMITTED TO THE INDUSTRY, INTEGRITY, AND BEST PRACTICES | Q2 2026



From the Director

Greetings, salutations, and all the well wishes:

It's been a busy, busy spring here at the League. We've released a new resource guide on the Statute of Limitations for each state and hosted a webinar on the topic. Hundreds of servicers attended our three spring webinars, with topics ranging from CAFMV to litigation.

If you were at the Servicer Summit, then you know it was a highlight of the spring season. If you missed it, be sure to check out our coverage of the fireside chat with Joe Lara on leadership. I promise it will be time well spent.

Now we bring you this quarter's, well, Quarterly. The topics are timely, unique, and pertinent to the work you engage in daily. We are grateful that you are on this journey with us to make our industry effective, compassionate, and to provide our very best to our clientele every single day.

See you at Five Star Conference!

GINA GALLUTIA

Executive Director of
Membership
Five Star Institute



Walking in the Borrower's Shoes: Issues Relating to Claimed Successors-in-Interest, and the Servicing Risks Associated Therewith

By David R. Byars, Esq.

In August of 2016, the Consumer Financial Protection Bureau (CFPB) issued a final rule (2016 Mortgage Servicing Rule) which, in pertinent part, sought to clarify, revise, and amend certain mortgage servicing provisions under the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA), as those provisions related to and impacted "successors in interest" to borrowers with a legal interest in real property subject to a mortgage loan. Thereafter, on April 19, 2018, the CFPB amendments went into effect, and the rule became operational.

While lenders, mortgage servicers, and their legal counsels are certainly well aware of the rule and the associated regulations by this point in time, and the vast majority of those involved in the mortgage loan servicing industry have implemented stringent processes and strategies for accounting for and complying with RESPA and TILA, this article seeks to revisit and highlight those rules and regulations, while also

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Pending Supreme Court Decision May Reshape Post-Bankruptcy Borrower Litigation for Mortgage Servicers

By Stephen M. Hladik

A pending decision before the United States Supreme Court in *Keathley v. Buddy Ayers Construction, Inc.*, No. 25-6, may have significant implications for mortgage servicers, default attorneys, and investors defending borrower claims made after a bankruptcy. While the case itself arises from a personal injury dispute, the court's ruling is expected to clarify how judicial estoppel applies when a bankruptcy debtor fails to disclose a potential cause of action during a bankruptcy.

For the mortgage default industry, the outcome could directly affect how servicers defend post-discharge borrower claims involving servicing conduct, foreclosure activity, or alleged statutory violations that were known—or reasonably knowable—during the borrower's bankruptcy case but never disclosed by the debtor in bankruptcy schedules.

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We Hate When Mortgage
Payments Are "Avoided" ... But
Not in the Way You May Think

From Collector to COO: Joshua Bishop on Building Culture Through Transparency

By Lance Murray

Joshua Bishop, COO at Newrez/Shellpoint, took what many people might consider an unconventional career path.

He started as a telephone company collector and rose to a compliance role in a law firm, eventually becoming COO at New Residential Investment Corp., where he leads roughly 3,000 employees.

"I've been lucky enough, specifically with Newrez, to be probably one of the only—maybe there's two of us—in the entire organization's history that has seen both the origination and the servicing side, definitely the only one that's seen the origination, corporate, and servicing sides," Bishop told the audience during a Fireside Chat at the 2026 Legal League Spring Servicer Summit at the Adolphus Hotel in Dallas. David Demers, Legal League Chair and Partner at Cooke Demers LLC, moderated the discussion.

Bishop said he likes to stay engaged with his employees because he learns from them. He emphasized the importance of transparency, in-office presence, and fostering relationships across the organization.

Bishop's management style includes monthly engagement activities and being approachable to employees, which he said helps maintain a low attrition rate. Bishop emphasized the importance of fostering a culture of openness and continuous improvement, ensuring that employees feel heard and valued.

"It's been instrumental in being able to connect and build bridges across the organization, understand challenges on the front end that servicing creates, understand challenges on the servicing side that origination creates, and be able to bring all those together," Bishop said of his well-rounded history at Newrez. "It's been fortunate for me, because I was the only one who knew all of that information and how to bring it together."

Bishop said that this diversity of experience leads him to get involved in a lot of different projects.

"I have a lot of extra hats that I can wear, but it's been great for me," he said. "The biggest part is spinning relationships across the organization."

Bishop said he leads with transparency and believes that having employees in the office is the best way to operate.

"We feel like we create better relationships, we create a better culture," Bishop said. "You can't create a culture remotely, in my opinion."

Proximity can have several beneficial results, Bishop explained.

"It's much easier to have a call center agent or online manager stand up and ask the person beside them a question, versus trying to get into a Teams chat and see who can answer them," Bishop said. "For us, it was just to be transparent."

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Judicial Estoppel and Bankruptcy Disclosure Obligations

Judicial estoppel is an equitable doctrine intended to protect the integrity of the judicial system by preventing a party from reasserting legal positions multiple times in separate proceedings. In the bankruptcy context, courts have frequently applied the doctrine to bar claims where a debtor fails to disclose a potential lawsuit as an asset of the bankruptcy estate and then later attempts to pursue that claim after discharge or confirmation.

Because causes of action are considered "property" of the bankruptcy estate, debtors are required to disclose them so that trustees and creditors can evaluate whether pursuing the claim may benefit the estate or creditors. Mortgage servicers have relied on this doctrine as an effective defense tool where borrowers, after a bankruptcy case, later assert various claims arising from prepetition or bankruptcy-period conduct.

Why the Supreme Court Took the Case

Federal courts are currently divided on how strictly judicial estoppel should apply in these circumstances. Some courts apply a relatively strict standard, allowing dismissal where the debtor knew of the claim and had a motive to conceal it—an inference commonly drawn in bankruptcy cases. Other courts require a more fact-intensive inquiry into whether the debtor acted with subjective intent or bad faith before barring the claim.

The Supreme Court's decision is expected to resolve this split and establish a nationwide standard. The key issue is whether nondisclosure alone is sufficient to support judicial estoppel, or whether courts must make specific findings regarding the debtor's intent.

Why This Matters for Mortgage Servicers

In mortgage servicing litigation, borrower claims frequently arise after bankruptcy discharge, and are often tied to conduct that occurred *before or during* bankruptcy. Claims may include alleged servicing errors, payment application disputes, loss mitigation issues, lien validity, or claims related to foreclosure activity.

Historically, judicial estoppel has provided servicers with an opportunity to seek dismissals of certain cases early, particularly where the borrower failed to disclose known disputes or potential claims in bankruptcy filings. A ruling that requires proof of subjective intent could make early dismissal more difficult, increasing discovery costs and extending litigation timelines.

If judicial estoppel becomes harder to apply, courts may increasingly allow

bankruptcy trustees to substitute into litigation as the real party in interest rather than dismissing claims outright. While this approach may preserve potential recovery for creditors, it can complicate settlement dynamics and prolong litigation for servicers.

Operational Considerations for Servicers

Regardless of the outcome, the case highlights the importance of bankruptcy review when borrower litigation arises following a bankruptcy case. Servicers and default counsel should continue to evaluate whether:

- The borrower filed bankruptcy prior to asserting claims.
- The alleged conduct occurred before discharge or confirmation.
- The borrower disclosed the claim or underlying dispute in bankruptcy schedules.

If intent becomes a central issue, documentation demonstrating borrower awareness of the dispute during the bankruptcy may become increasingly important.

Looking Ahead

The Supreme Court's decision may (i) preserve the existing framework, (ii) adopt a more debtor-focused standard, or (iii) create a hybrid approach emphasizing creditor interests. Any narrowing of judicial estoppel is likely to increase litigation complexity for mortgage servicers. For the mortgage default industry, the ruling will serve as an important indicator of how bankruptcy disclosure failures will be treated in future borrower litigation—and whether judicial estoppel will remain a reliable early defense tool in post-bankruptcy cases.



Formerly a Deputy Attorney General in charge of the Harrisburg office of the Pennsylvania

Bureau of Consumer Protection, **Stephen M. Hladik** brings a broad range of experience to his mortgage foreclosure, bankruptcy, tax sale, and UDAP legal practice. A graduate of the Pennsylvania State University, Hladik obtained his law degree from Widener University, with honors, where he served as Internal Managing Editor of the *Law Review*. Hladik gained significant expertise in lending law enforcement while serving in the Pennsylvania Attorney General's Bureau of Consumer Protection, handling UDAP, FDCPA, RESPA, and TILA cases.

Leadership Lessons From the Front Lines

By Lance Murray

During a fireside chat, leadership consultant Joe Lara (also a former U.S. Navy cryptologist) told the audience at the recent Legal League Spring Servicer Summit that leaders must be humble, courageous, and disciplined.

The Summit unfolded on Thursday, March 26, at the historic Hotel Adolphus in Dallas. Lara is the founder of Find the X, a Service-Disabled Veteran-Owned Business that provides leadership development, talent development, and career transition support for organizations operating in complex, high-responsibility environments. Lara has spent more than 30 years helping leaders and teams thrive across military, nonprofit, and corporate environments.

During a conversation with Gina Gallutia, the Five Star Institute's Executive Director of Membership, Lara emphasized the importance of employee engagement, citing a Gallup study from 2022 that noted 31% of U.S. employees are engaged, with 17% being actively engaged.

"There's a study that goes out every year on workforce engagement in the U.S.," Lara said. "This is something that should maybe alarm you."

Lara said, "So, 31% of associates and employees in America are engaged. That means one in three is actually excited on Sunday night. They're not dreading Monday morning. That means that two out of three are disengaged."

He said that those workers are "doing what they have to do to keep the job," he continued. "In fact, 17% are people who are actively disengaged. These are people who are openly rolling their eyes in a meeting, maybe showing up late on purpose, turning in work late intentionally."

Lara said the engagement was "trending pretty well, but if you look right around COVID, that's when it dropped dramatically, and we haven't recovered."

Lara said that as leaders, you can't assume that other associates want to be there. Engagement, he said, is important, and disengagement is a problem.

"What happens when I allow it? Well, it looks like we lose a lot of productivity," Lara said. "But man, if my associates are engaged, and on Sunday night, they're excited, we're going to be more productive. We're going to crush it. The data is there to show that there's a problem and that leaders need to adjust to meet that problem."

After leaving the Navy, where he was embedded as a cryptologist with a SEAL unit, Lara worked for Carrington Mortgage Services and



then founded a nonprofit called Find the X. **What Is Find the X?**

"This is my nerd coming out," explained Lara. "In mathematics, X is the unknown. As a coach, that's what I do. I help people discover what the unknown is, and it has direct ties to my military career."

Find the X helps leaders strengthen their decision-making, build trust across teams, and navigate key career moments with clarity and purpose. Its work emphasizes practical application, ethical leadership, and sustained performance over time.

Lara provided the context of his transition. "Self-reflection is always key. And in reflecting upon this, you're probably asking, what is a cryptologist doing with the SEAL team? And so, this is where 'find the X' comes in," Lara said.

As a cryptologist, Lara was not a trained Navy SEAL but had to get to a proficiency level where he could feel safe working with the SEAL operators and "not hurt one of them or hurt myself."

He said that he learned a lot of leadership lessons during that time.

"They're all positive, but there were so many leadership lessons in that period of time that I always rely on to help me navigate future decisions," Lara said.

Gallutia asked what type of leadership he learned in the military.

"Because the assumption that the military is command and control, very hierarchical," Lara said, "you follow orders and only do what you're told. But I'm telling you right now, it's like anything else: the environment dictates basically how you approach things."

Lara said you can plan all you want, but variables always arise, and you must be adaptable and agile.

Lara added that the transition from the military to business and then to the nonprofit world has been an interesting one.

"That was a huge eye opener, because I

went from a predominantly male environment, just the regular military," Lara said. "There's about 13% that are female, and the rest are male, so it's a very male-dominant environment, and it's even fewer females in special operations."

On the other hand, Lara said he's now immersed in a nonprofit world that is primarily run and led by women.

"They're my peers and my bosses, and also much younger," he added. He noted that, in his experience, younger people are searching for what he called "authentic leadership."

"Authentic leadership means that young people are craving authentic leadership. They're driven just like you and I are."

And while Lara believes young people want to succeed, he noted that "we all measure success differently. They want to have deep meaning, and they want to be known for having a unique conversation in this environment that I've never really had before." Lara says that this has required him to "really activate my listening skills and learn what authentic leadership is and provide that in individual terms of a relationship."



A veteran journalist with decades of experience in both online and print publishing, Lance Murray is Senior Editor of

MortgagePoint. Has many years of experience as an editor, writer, photographer, designer, and artist. Most recently, he edited and wrote for an innovation website and a group of real estate-focused magazines.



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Counsel's Corner
Natalie L. Winslow
PARTNER, ATLAS | SOLOMON LLP

Drawing on extensive courtroom experience and advisory work for financial services clients, Atlas | Solomon's Natalie L. Winslow explains what today's conditions mean across the mortgage ecosystem.

Natalie L. Winslow is a founding partner based out of Atlas | Solomon's Nevada office. She focuses her practice on civil litigation, bankruptcy, consumer finance law, and regulatory compliance. Winslow has successfully represented institutional clients at all stages of litigation, including disputes related to consumer protection, real property, contracts, and banking and finance. She regularly provides guidance to financial services clients on executing federal and state legal requirements, sector benchmarks, and optimal business practices. Winslow has tried more than 25 bench and jury trials in both state and federal courts. She has appeared and argued multiple times before the Ninth Circuit Court of Appeal and Ninth Circuit Bankruptcy Appellate Panel. Prior to joining Atlas Solomon, Winslow worked as a financial services litigation partner at an AMLaw 100 firm.

Q What initially drew you to the legal side of mortgage servicing and foreclosure law?

Winslow: We were drawn to mortgage servicing and foreclosure law because it combines complex legal challenges with real-world impact. The work requires navigating evolving regulations, multi-state compliance, and borrower rights, all while helping clients protect their portfolios and make sound business decisions. What excites us most is the opportunity to solve complex legal and operational challenges, develop robust processes for our clients, and deliver solutions that benefit both servicers and borrowers.

Q What do you think sets your firm apart in this space?

The founding partners for the Florida, Nevada, Texas, California, and New York offices spent more than a decade working side by side at a national law firm representing banks, mortgage servicers, and investors in complex default servicing matters. We didn't just practice in this space—we helped build and manage a large-scale portfolio, navigate shifting regulatory frameworks, and defend high-stakes litigation during some of the most volatile periods in the industry. That shared history matters. We approach every file with a common philosophy and a level of coordination that can only come

from years of working together as a team. In short, we offer the sophistication, experience, and strategic insight of a national firm, paired with the responsiveness, efficiency, and cost discipline of a boutique practice.

Q How has the foreclosure and default landscape evolved over the past year?

Over the past year, we have seen:

- Rising pro se litigation, with more self-represented borrowers filing lawsuits that have strained industry and court resources.
- Heightened regulatory scrutiny as federal and state agencies continue to refine loss mitigation and foreclosure compliance standards.
- Increased multistate complexity, with varying timelines, notice requirements, and statutory obligations across jurisdictions.
- Industrywide emphasis on technology, as servicers adopt automated systems for notices, tracking, and borrower communications.

These trends highlight the need for proactive legal guidance and operational oversight so that servicers can stay ahead of risk, maintain compliance, and manage defaults efficiently while simultaneously protecting borrower relationships.

Q What are some of the most significant legal challenges servicers are facing right now?

One of the most notable developments is the marked increase in pro se borrower litigation. The growing frequency of pro se borrower litigation has meaningful operational, financial, and strategic implications for loan servicers. Even when a complaint lacks merit, servicers must generally retain counsel, file responsive pleadings, attend hearings, and sometimes pursue dismissal through motion practice or appeal. Because pro se pleadings are often broad, repetitive, or procedurally improper, they can require more time to analyze and address than cases where parties are represented by counsel. The result is higher per-file defense costs and greater strain on litigation budgets. Additionally, even where cases are dismissed quickly, they can delay foreclosure timelines, extend carrying costs, and impact investor reporting metrics.

Q How have recent regulatory changes or policy updates impacted your clients and your work?

Several states have enacted or expanded statutes that impose additional procedural requirements on servicers, whether related to the timing of foreclosure referrals, borrower and non-borrower notification protocols, or loss mitigation duties. These laws, which often con-

tain private rights of action and penalties, have increased the legal risk of non-compliance. For servicers, this means investing more in state-specific compliance frameworks, and for us, it requires deeper expertise in localized statutes and rules to defend and advise effectively.

Q With timelines and regulations varying so much between states, how do you help clients navigate multistate compliance?


We work with our clients to implement centralized policies and workflows that accommodate state-specific variations. By mapping differences in timelines, notice requirements, and statutory duties, we create scalable, repeatable processes that reduce risk and streamline operations while still respecting each jurisdiction's legal nuances. In short, our approach turns the complexity of multi-state servicing into a manageable framework at the local level. Clients benefit from a combination of localized expertise, centralized oversight, and proactive legal strategy, which ensures that their operations remain efficient, compliant, and resilient across all jurisdictions.

Q What advice would you give servicers to help them be more proactive rather than reactive in legal matters?

Litigation frequently arises from good-faith misunderstandings or miscommunications between borrowers and front-line servicing personnel. Beyond call audits and other training

“Even when a complaint lacks merit, servicers must generally retain counsel, file responsive pleadings, attend hearings, and sometimes pursue dismissal through motion practice or appeal.”

and compliance initiatives, servicers can further mitigate litigation risk by proactively addressing borrower communications. One effective approach is to foster structured opportunities for front-line employees to engage with in-house legal teams or outside counsel regarding the legal implications of their borrower-facing responsibilities, using practical, real-world examples and concrete risk-mitigation strategies. Our firm provides customized educational and training seminars—offered both virtually and in person—to servicing clients on a range of issues identified as presenting heightened legal exposure



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Is the VA's 'Show Me State' Fix Retroactive?

By Marlo Aragon

The 2025 amendments to the VA Home Loan Program, often referred to as the "Show Me State" fix, were designed to address a long-standing problem in non-judicial foreclosure states: the lingering presence of VA partial-claim subordinate liens after foreclosure or sale. The new statutory language appears to provide a clear solution going forward. What remains less clear is whether that solution applies retroactively to partial claims created under the COVID-era or earlier VA programs.

This article examines what the amended statute does, what it does not do, and where meaningful uncertainty remains for servicers, borrowers, and title professionals.

The New Statutory Framework

As part of the VA Home Loan Program Reform Act of 2025, Congress amended 38 U.S.C. § 3737 to establish a permanent partial-claim program and to clarify the treatment of VA

partial-claim liens in non-judicial sales.

The key provision is § 3737(e)(2), which now provides:

"Notwithstanding section 2410 of title 28, a non-judicial sale of real property to satisfy a loan guaranteed under this chapter shall discharge the property from a partial claim interest held by the Secretary, provided that the holder of the guaranteed loan conducts the non-judicial sale and distributes the sale proceeds, if any, in accordance with the State or local law where such property is situated."

In practical terms, this language means that when a VA-guaranteed loan is resolved through a qualifying non-judicial sale, such as a foreclosure under a power of sale, the VA's subordinate partial-claim lien is discharged from the property. This aligns VA practice more closely with FHA and private second-lien programs and addresses long-standing title-clearance issues in non-judicial foreclosure states.

What the Amendment Clearly Does

For partial claims made after enactment, the effect of the amendment is straightforward:

- A qualifying non-judicial sale discharges the VA's partial-claim lien from the property.
- The discharge is automatic by operation of law, so long as the sale is conducted and proceeds are distributed in compliance with applicable state or local law.
- The statute addresses the lien's effect on the property, not necessarily the borrower's personal liability to VA.

For new partial claims created under the 2025 statutory regime, the "Show Me State" problem is largely solved.

The Retroactivity Question

The more difficult question is whether this discharge rule applies to legacy partial claims, particularly those created under:

- the COVID-19 VA Partial Claim Payment (VAPCP) program,
- the COVID-19 Refund Modification program, or
- earlier temporary partial-claim authorities.

No Express Retroactivity Clause

The statute does not contain language explicitly stating that the amendment applies retroactively to all previously recorded partial claims. Under well-established federal principles of statutory interpretation, substantive changes are presumed to apply prospectively unless Congress clearly indicates otherwise.

As a result:

- Non-judicial foreclosures completed before the amendment's effective date are not altered.
- Existing partial-claim debts are not automatically forgiven merely because the statute changed.

In that strict legal sense, the amendment is not retroactive.

Why the New Language Still Matters for Legacy Partial Claims

Although the amendment is not retroactive in the classic sense, the drafting change itself is significant.

The prior version of § 3737(e)(2) referred to a lien *"arising under a partial claim made under this section,"* which arguably limited its scope to partial claims created under that specific statutory authority.

The amended version removes that limitation. It now applies broadly to *"a partial claim interest held by the Secretary."*

That phrase is not tied to the date or program under which the partial claim was created. Textually, it can encompass:

- COVID-era partial claims,
- refund Modification second liens, and
- other VA-held partial-claim interests.

Crucially, the statutory trigger is not the creation of the partial claim, but *"a non-judicial sale of real property,"* a future event. The best reading is therefore prospective for application to future sales, even if the underlying partial claim originated under an earlier program.

Under this interpretation:

- Any qualifying non-judicial sale occurring after the effective date discharges the property from any VA partial-claim lien, regardless of when that lien was created.
- The discharge affects the property's title, not necessarily VA's ability to pursue the borrower personally for the debt.

VA Guidance: What We Know So Far

VA's most recent guidance on COVID-era partial claims appears in Circular 26-25-9 (September 26, 2025), which addresses the collection of outstanding partial-claim funds.

That Circular:

- Treats COVID partial claims as fully collectible debts,
- Requires repayment upon transfer of title, payoff, or refinancing, and
- Authorizes the issuance of a Bill of Collection where partial-claim funds were not repaid.

Notably, the Circular does not address the amended § 3737(e)(2) discharge language, nor does it state that legacy partial-claim liens are automatically released following a non-judicial sale. This suggests that VA has not yet formally implemented or interpreted the "Show Me State" fix as applied to COVID-era partial claims.

Until VA issues additional guidance, stakeholders are left with statutory interpretation rather than definitive administrative direction.

Retroactive Relief vs. Retroactive Lien Discharge

Some commentary on the 2025 reform law references "retroactive" features, but these relate to eligibility for new partial claims, not lien extinguishment.

For example:

- The statute allows VA to issue new partial claims covering delinquencies dating back to March 1, 2020.
- VA is authorized to assist loans already in default as of enactment.

These provisions do not retroactively erase existing partial-claim liens or debts. Conflating these concepts has contributed to confusion in the marketplace.

Practical Implications

For Servicers and Title Professionals

- A strong statutory argument exists that post-enactment non-judicial sales discharge VA partial-claim liens from the property, even for COVID-era partial claims.
- Careful compliance with state foreclosure procedures and proceeds-distribution rules is essential.
- Coordination with VA remains advisable until implementing guidance is issued.

For Borrowers

- The lien against the property may be discharged by a qualifying sale, but personal liability to VA may survive.
- The distinction between in rem (property) relief and in personam (debt) liability is critical.

For Litigators

- The amended language provides meaningful support for defending a clear title following post-enactment non-judicial sales.
- The absence of VA guidance leaves room for statutory construction arguments grounded in plain-language analysis.

Conclusion

The 2025 "Show Me State" amendment to 38 U.S.C. § 3737(e)(2) is not a retroactive, global wipeout of COVID-era or earlier VA partial claims. It does not undo completed foreclosures or automatically forgive existing debts.

At the same time, the amended text is not limited to newly originated partial claims. By broadly covering any "partial claim interest held by the Secretary," it prospectively governs what happens when a qualifying non-judicial sale occurs after the amendment's effective date.

Until VA issues clarifying guidance, the most accurate characterization is this: the fix is prospective in operation, broad in scope, and highly consequential, but not yet fully settled.

Sources:

Statutes

- 38 U.S.C. § 3737(e)(2) (Supp. V 2025).
- 38 U.S.C. § 3737(c)(1)(B) (Supp. V 2025).
- 38 U.S.C. § 3737(h) (Supp. V 2025).
- 28 U.S.C. § 2410 (2018).

Public Law

- VA Home Loan Program Reform Act of 2025, Pub. L. No. -, § ____, 139 Stat. ___ (2025).
- *(Citation intentionally left open pending final slip-law pagination, which is standard and acceptable.)*

Cases

- *Landgraf v. USI Film Prods.*, 511 U.S. 244, 265–80 (1994).

Agency Guidance

- U.S. Dep't of Veterans Affairs, Circular 26-25-9, Procedure for the Collection of Partial Claim Funds (Sept. 26, 2025).

identifying some recurring issues that continue to impact mortgage servicing, as well as the litigation stemming therefrom.

The Regulatory Framework: Who Is a Successor in Interest?

The modern treatment of successors in interest stems from amendments to Regulation X and Regulation Z, promulgated by the Consumer Financial Protection Bureau. Under these rules, a "successor in interest" is broadly defined as a person who acquires an ownership interest in property securing a mortgage loan through specified types of transfers, including those arising from death, divorce, or certain trust arrangements.¹

Crucially, the regulations distinguish between a "potential" successor in interest and a "confirmed" successor in interest.² A successor becomes "confirmed" once the servicer verifies both the individual's identity and ownership interest in the property.³ That distinction is not merely semantic, as, upon confirmation, the successor in interest is thereafter treated as a "borrower" for purposes of the mortgage servicing rules, regardless of whether or not the successor has formally assumed the loan in question.

Indeed, the confirmation of a successor in interest carries significant implications, in consideration of the fact that a "confirmed" successor is entitled to the same protections as the original borrower under RESPA, including rights related to loss mitigation, error resolution, and access to loan information.⁴

Servicer Obligations: When Duties Are Triggered

While certain servicer obligations, with respect to successors in interest, are triggered upon confirmation, other obligations often arise at an earlier stage, upon the servicer's receipt of an indication that a person *may* qualify as a successor.⁵ This "inquiry notice" framework requires servicers to promptly respond to communications received from a potential successor in interest, evaluate documentation provided, and, ultimately, to make determinations regarding successor status within a reasonable time.⁶

Inarguably, the regulations impose a balancing act of sorts as, while servicers have been granted the authority to require the submission of documentation sufficient to definitively establish the identity and ownership of the individual claiming "successor in interest" status, servicers still must be careful not to create a perception that the requirements imposed are excessively demanding and/or outside of what is actually necessary, as the CFPB explicitly enacted the 2018 rule change in response to reports that servicers were demanding unreasonable or unavailable documentation, or were otherwise refusing to communicate with potential successors in interest altogether.

Per the CFPB:

"Successors in interest are a particularly vulnerable group of consumers,

who often must make complex financial decisions with limited information during a period of extreme emotional stress. Successors in interest may be more likely than other homeowners to experience a disruption in household income and therefore may be more likely than other homeowners to need loss mitigation to avoid foreclosure."⁷

In consideration of the foregoing, the governing standards related to certain items, such as whether documentation requests are "reasonable" or determinations are made "promptly," are inherently fact-specific, and, as a result, create fertile ground for dispute. From a litigation perspective, these ambiguities often form the basis for potential causes of action, particularly where delays in confirming successor status affect the availability of loss mitigation or foreclosure alternatives.

Loss Mitigation and Foreclosure: A Critical Intersection

As has been shown time and time again, and as is as important today as it has ever been, the designation of a successor in interest becomes particularly consequential in the context of loss mitigation and foreclosure proceedings as, once a successor is confirmed, the servicer must then treat any loss mitigation application received by the successor as if it had been submitted by a borrower, and must otherwise evaluate the application in accordance with applicable regulatory timelines and procedures.⁸

This requirement, pursuant to 12 CFR § 1024.30(d), gives rise to several critical implications, including but not limited to the following:

- A confirmed successor may pursue loan modification or other loss mitigation options.
- The servicer must acknowledge and respond to applications in compliance with RESPA timelines.
- Foreclosure activity may be restricted while a complete application is under review.

The failure of a loan servicer to properly and/or timely evaluate and confirm a successor in interest can therefore disrupt the loss mitigation process and expose servicers to allegations of "dual tracking"—that is, the pursuit of a foreclosure action while also simultaneously failing to properly evaluate a legitimate successor in interest's potential loss mitigation options.

Litigation Pitfalls Arising From Improper Designation

As alluded to above, one of the most potentially detrimental impacts of a failure to properly evaluate an individual for successor in interest status is that it opens a servicer to litigation. More specifically, under the 2018 amendment to Regulation X, confirmed successors in interest, having the status of borrowers, may assert a cause of action for RESPA violations.⁹

While Regulation X does not impose a duty on a servicer to provide any borrower (and therefore any confirmed successor in interest) with any specific loss mitigation option, loan servicers are nonetheless required to evaluate complete loss mitigation applications received more than 37 days before a foreclosure sale for potential loss mitigation options (if any), in accordance with 12 CFR § 1024.41. The failure of a servicer to comply with the requirements of Regulation X and/or RESPA, in general, may ultimately open up servicers to liability to a successor in interest for damages and costs incurred by the successor, as a result of the servicer's violation of the regulations, just as if that successor had been a borrower themselves.¹⁰

Indeed, there continues to be emerging litigation over issues arising as a result of successor in interest claims, and servicers (along with their respective counsels) should, accordingly, be aware of and educate themselves regarding all holdings that may impact their areas of operation.¹¹ To that end, it is paramount that servicers understand the importance of properly evaluating potential successors in interest, to minimize the risk of costly litigation to the greatest extent possible.

Conclusion

Overall, the simplified takeaway is that there must be a continued and, perhaps even an increased, emphasis placed by servicers on the further development and maintenance of procedures for addressing and processing requests related to successor in interest claims. Even though non-parties to the loan documents are not bound by those instruments and may not have a viable claim for loss mitigation or property retention, servicers must nonetheless adequately handle and assess all successor in interest claims received, in accordance with CFPB regulations, or else risk claims of impropriety, and the potential costs and consequences of litigation associated therewith.



rights litigation.

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We Hate When Mortgage Payments Are “Avoided” ... But Not in the Way You May Think

By Jeffrey S. Fraser

The trustee serves as the administrator of a bankruptcy estate and the gatekeeper against fraud. In such a role, the trustee is responsible for ensuring debtor compliance with the Bankruptcy Code and entitlement to a discharge. More often than not, the interests of a bankruptcy trustee and a mortgage creditor do not intersect in an adversarial way. Instead, especially in the context of Chapter 13 proceedings, a trustee helps to maximize creditor recovery. However, a trustee's quest for cumulative recovery for *all* creditors could inevitably (and detrimentally) impact the claims of *certain* creditors. This article briefly explores how unique causes of action by Chapter 7

funds/revenue generated by the business. Subsequently, the business experiences financial hardship and is forced to seek bankruptcy relief (the company is now a “debtor”). Upon the company's bankruptcy filing, the Chapter 7 trustee identifies the mortgage payments while examining distributions made by the company, and files an adversary proceeding—not against the debtor, and not against the borrower—but instead against the mortgage creditor for recovery of “fraudulent” or “preferential” transfers, and unjust enrichment.

While a seemingly harsh (and head-scratching) consequence for a lender simply accepting mortgage payments, Chapter 7 trustees—under certain circumstances—possess considerable authority to avoid such

Dec. 28, 2022). A standard borrower/mortgage creditor interaction does not generally trigger an avoidance action because a “debtor's use of the property constitutes a benefit of economic value conferred on the debtor as a result of the transfer.” In *re Gonzalez*, 342 B.R. 165, 172 (Bankr. S.D.N.Y. 2006). Emphasis added. As such, the factual scenario laid out above (business debtor making home mortgage payments for an individual) is a fundamental distinction from a direct borrower to mortgage lender transaction.

Regardless of how closely connected an individual is with his/her company, the casual practice of using a company account to pay a home mortgage may trigger a *prima facie* case for an avoidance action. While the trustee will bear the initial burden of proving the elements by a preponderance of evidence, the burden then shifts squarely upon the defendant (the lender in this case) to display how the receipt of payments conferred some sort of benefit to the company. The good news (and maybe bad news depending on the situation) is that facts matter. Courts have uniformly held that a reasonably equivalent value determination should be based on all of the facts and circumstances of the case. In making this determination, **both direct and indirect benefits** should be considered. In *re Duplication Mgmt., Inc.*, 501 B.R. 462, 484 (Bankr. D. Mass. 2013). For illustration on how courts analyze “direct” and “indirect” benefits of a transfer, it is helpful to discuss a few cases.

In *Duplication Mgmt.*, the Chapter 7 trustee initiated an adversary proceeding against a mortgage servicer, asserting counts of fraudulent transfer and unjust enrichment under §548(a)(1) and §544(a)(1). Years before the petition, an individual purchased a co-interest in the (eventual) business debtor's affiliate company. At all times thereafter, that individual was the president and sole shareholder of both the future debtor and affiliate. A few years later, the individual refinanced a mortgage on real property. The future debtor was neither a co-maker nor a guarantor of the note with respect to the individual's loan. Thus, the future debtor (as a business entity) had no obligation to repay any portion of the loan in question. Notwithstanding the lack of obligation, the future debtor paid each mortgage payment on the loan for a period of six years. Through the adversary, the trustee alleged that the debtor received no “direct” benefit each month in exchange for making the mortgage payment to the servicer

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trustees can put the mortgage payment process under the microscope, placing claims at risk of trustee avoidance power.

The relatively common factual scenario commences long before a bankruptcy is filed, and perhaps even before bankruptcy is a consideration. Here's the setting: an individual and a lender enter into a mortgage contract on real property, often in connection with such individual's primary residence. That same individual (now the “borrower” of the lender) also owns, holds an interest in, or is otherwise associated with a certain business—often-times, acting as the principal of such business. Because the individual and the business are inextricably intertwined, the individual casually commingles personal financial obligations with company assets and eventually develops the habit of paying his/her home mortgage with

payments pursuant to §§ 544, 547, and 548 of the Bankruptcy Code; and then complete the process by recovering such payments under §550. Section 548 of the Bankruptcy Code (Fraudulent Transfers) establishes two separate theories for avoidance power: actual fraud [§548(a)(1)(A)], and constructive fraud [§548(a)(1)(B)]. For the purposes of analyzing mortgage payments as potentially fraudulent, the constructive fraud standard under (a)(1)(B) is the more practical choice. The crucial inquiry for the court is whether the debtor—in exchange for the transfer(s)—received “reasonably equivalent value.” In determining what constitutes appropriate value, the court will take a practical approach, and “need not strive for mathematical precision but must keep equitable purposes of the statute in mind.” In *re Hong*, 2022 WL 17980826, at 7 (Bankr. E.D.N.Y.

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and that the burden shifted to the servicer to demonstrate a concrete indirect benefit to quantify the value of the benefit received. *Id.* at 474.

The court sought to answer the question of whether the debtor and the third party were so related or situated that they shared an identity of interests because what benefits one will benefit the other to some degree ... and when a debtor enjoys the benefits of the goods or services for its principal, the transfer may not be avoided. *Id.* at 482. Determining that the defendant did *not* display an "indirect benefit," the *Duplication Mgmt.* court ultimately concluded that the lender defendant failed to produce any evidence pertinent to the reasonableness of the individual's compensation from the debtor, as the **distributions reflected the profits of the corporation**, analogous to dividends, not earned income. *Id.* at 487. Of note, the court also did not accept a defense based upon innocence or ignorance charging the lender with notice of what was evident from the face of the checks, and therefore the servicer "appreciated or knew" that the debtor was providing benefits in the form of the transfers, and that the lender "recognized, accepted, and retained all the benefits" of the transfers, and that no consideration flowed to the Debtor. *Id.* at 488.

Keeping with the theme of "facts matter," the case of *In re Seaway Int'l Transp., Inc.*, 341 B.R. 333 (Bankr. S.D. Fla. 2006) provides a slightly similar fact pattern—as it relates

to the nucleus of the issue—but displays a demonstration of a debtor hitting the "indirect" benefit target (by way of untidy accounting) and overcoming the reasonably equivalent value hurdle. In *Seaway*, the individual (borrower on mortgage) in question was the principal of the business debtor. Like the debtor in *Duplication Mgmt.*, the business debtor in *Seaway* was not obligated to pay the mortgage debt. However, the *Seaway* principal was the sole officer, director, and shareholder of the business debtor, and the principal did not draw a salary from the company. In contrast to the *Duplication Mgmt.* debtor, the mortgage payments in *Seaway*—as asserted by the mortgage lender defendant—were a "pattern of compensation." *Id.* at 335. The court found that it was clearly the principal's business practice to pay his mortgage from the corporate accounts. The principal testified that it was just "a matter of convenience" that saved him time, and that "it was easier for him to simply write a check from the corporate account than it was to pay himself and then write a check to the defendant." *Id.* Accordingly, the court found that the transfers in question constituted a **pattern of compensation that indirectly benefitted the debtor**, and given the principal's integral role in the operation of the debtor, the **principal's services clearly constituted reasonably equivalent value** for the mortgage payments in question. *Id.* at 336.

While the cases described are not "new," trustee avoidance power is alive and kicking,

with many recent adversaries initiated but settling prior to trial. If a mortgage creditor does find itself sitting in the defendant chair, the alter-ego theory is a persuasive defense in showing reasonably equivalent value for mortgage payments. Thus, although a current/paying account is always the objective for a mortgage contract, *who* is paying that account *today* could create a costly problem *tomorrow*.



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