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A REPORT TO MEMBERS OF THE SOUTH CAROLINA BAR YOUNG LAWYERS DIVISION

The Use and Propriety of Medicare Set Asides in Liability Settlements

Garretson Firm Resolution Group, Inc.

This white paper analyzes the propriety of using Medicare Set-Aside Arrangements (MSAs) in liability settlements as opposed to the workers' compensation context. This memo contains the academic and legal underpinnings behind the current MSA debate, as well as practical guidance/tips for dealing with situations where a settling party (perhaps misinformed about the related requirements [or lack thereof]) is demanding a MSA in a liability settlement.

In all settlements, compliance with Medicare rules and regulations can involve two obligations: i) the satisfaction and discharge of Medicare's reimbursement claim for injury-related care from the date of injury through the date of settlement, and ii) the evaluation of obligations associated with future costs of care that may be provided to the claimant from date of settlement onward. In our experience, the most logical way to assure that these obligations have been satisfied is to review the relevant statutes as well as any guidance from the Centers for Medicare & Medicaid Services (CMS) interpreting those statutes and apply this information to the facts of each case. CMS is the federal agency charged by the U.S. Department of Health and Human Services with the administration of Medicare programs, including Medicare Secondary Payer (MSP). Accordingly, this white paper is based on the currently available guidance concerning satisfaction of Medicare's future interest in liability settlements.

MSA overview

The MSA obligation in a liability settlement is more complex and amorphous as compared to the traditional application in a workers' compensation (WC) settlement. If settlement involves a claimant who is entitled or soon to be entitled to Medicare, a WC settlement (indemnity

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and medical) has a definitive shift of future health care expenses from the WC carrier to Medicare. This shift-of-burden carries a clear obligation to protect Medicare's interest. In WC settlements involving Medicare beneficiaries, federal regulations provide that the liability for medical expenses incurred due to work-related injuries should not be shifted to Medicare from the responsible party. 42 C.F.R. §411.46. However, CMS' recommended means to protect Medicare's interest involves defining that portion of a Medicare beneficiary's WC settlement that relates to future cost of care. According to CMS' memoranda, these monies should be set aside to pay for the beneficiary's future work-related injury and/or illness. CMS has issued 12 policy memoranda from July 21, 2001, through April 3, 2009.

Federal regulations provide that Medicare will not pay for any medical expenses for the work-related injury or illness until the amount allocated to future medical expenses is exhausted. 42 C.F.R. §411.46. Because liability settlements often involve a mix of inter-related damages (beyond the statutorily defined silos of indemnity and medicals in the WC context), the application of the WC-oriented MSA principles (and associated guidance from CMS) is far from clear cut in the liability context. Accordingly, WC-oriented MSA principles cannot merely be grafted onto a liability case.

Medicare's recovery rights (the law)

Medicare's right of recovery extends both to the past and the future. Memorandum from Thomas L. Grissom, Director, CMS Center for Medicare Management, to All Regional Administrators, "Medicare Secondary Payer-Workers Compensation (WC) Frequently Asked Questions," question & answer No. 13 (April 22, 2003), *available at* www.cms.hhs.gov/WorkersCompAgencyServices (last visited August 17, 2009). This is the case for both liability and WC cases. In the case of future payments where a lump sum compensation award stipulates that the amount paid is intended to compensate the individual for all future medical expenses required because of the work-related injury or disease, federal WC regulations provide a mechanism whereby Medicare does not pay for such expenses until the amount of the medical expenses equal that part of the lump sum payment. Where a compromise settlement allocates a portion for medical expenses and reasonably recognizes the income replacement element (indemnity portion), CMS can accept such apportionment as a basis for determining Medicare's future payments. 42 C.F.R. §§411.46(a), (b) and 411.47(a).

In the case of past payments, Section 1862(b)(1) of the Social Security Act (42 U.S.C. §1395y(b)(1)) provides that *payment may not be made under Medicare for covered items or services to the extent that payment has been made, or can reasonably be expected to be made promptly, under a liability insurance policy or plan (including a self-insured plan).* 42 U.S.C. §1395y(b)(2), *amended by* Pub. L. No. 109-171, 120 Stat. 4 (2006). Thus, all past Medicare payments are conditioned on reimbursement to the Medicare program to the extent that payment with respect to the same items or services has been made, or could be made, **under a liability insurance policy** or plan (including a self-insured plan).

While CMS has released a myriad of memoranda formalizing MSA procedures for WC cases, it has yet to release formal standards or guidance for review of liability insurance settlements. Nevertheless, the law currently exists to expand the scope of MSAs to liability settlements should CMS choose to publish guidance doing so. To date, CMS has not chosen to expand its MSA guidance to specifically include liability settlements.

Workers' compensation settlements (and MSAs)

While the purpose of this white paper is to discuss the propriety of MSAs in the liability context, a discussion of WC fundamentals aids the reader in a holistic understanding of the underlying concepts. In the case of WC, reimbursing Medicare for conditional payments made on behalf of the Medicare entitled beneficiary (settling the case) from date of injury through date of settlement is not the whole story. Medicare's future interest also must be considered in WC settlements for which the obligation to pay future injury-related medical expenses is being permanently shifted from the WC plan to Medicare. In this regard, if a WC claimant will have future medical expenses as a result of his/her injury, the attorney is obligated to notify the claimant of the need to protect Medicare's interest. 42 C.F.R. §§411.46 and 411.47. The most accepted compliance method for this obligation is to calculate and fund a MSA. Memorandum from Parashar B. Patel, Deputy Director, CMS Purchasing Policy Group, Center for Medicare Management, to All Associate Regional Administrators, "Workers' Compensation: Commutation of Future Benefits" (July 23, 2001), *available at* www.cms.hhs.gov/WorkersCompAgencyServices (last visited August 17, 2009).

While CMS' future interest must be considered in all WC settlements, CMS only will "review and approve" WC settlements (and associated MSA calculations) that meet certain thresholds. Social Security Act §1862, *as amended*, 42 U.S.C. §§ 1395y(b)(2), 1395y(b)(5)(d), 1395y(b)(6), *amended by* Pub. L. No. 109-171, 120 Stat. 4 (2006); *see also* "Medicare Secondary Payer (MSP) – Workers' Compensation (WC), Additional Frequently Asked Questions," question & answer No. 2 (July 11, 2005), *amended by* "Workers' Compensation Medicare Set-Aside Arrangements (WCMSAs) and Revision of the Low Dollar Threshold for Medicare Beneficiaries" (April 25,

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2006), *available at* www.cms.hhs.gov/WorkersCompAgencyServices (last visited August 17, 2009). Although CMS approval of the set-aside calculation is not mandatory, it adds a layer of protection and helps avoid any potential complications with future Medicare coverage. "Workers' Compensation: Commutation of Future Benefits" (July 23, 2001), *available at* www.cms.hhs.gov/WorkersCompAgencyServices (last visited August 17, 2009). Here, CMS suggests that workers' comp claims should not be settled until CMS can review the settlement and approve the set-aside allocation. "Medicare Secondary Payer (MSP)—Workers' Compensation (WC) Additional Frequently Asked Questions," question & answer No. 2 (July 11, 2005), *available at* www.cms.hhs.gov/WorkersCompAgencyServices (last visited August 17, 2009). Here, Medicare asserted its authority to disregard any settlement that does not protect Medicare's past and future interest. CMS approval also ensures that only a predefined portion of the settlement, rather than the entire settlement, must be spent before Medicare resumes payment of future injury-related medical expenses. If CMS approves the set-aside, you can be certain Medicare will resume primary coverage after the claimant demonstrates that the set-aside proceeds were properly depleted. While such certainty gives some peace of mind, obtaining it often comes at a price of additional time and money. Parties are forced to accept CMS' methodologies for calculating the set-aside without any right of appeal, and the agency may take six months or longer to review and approve the calculations submitted. If the attorney does not seek CMS approval, it is imperative to memorialize the comprehensive efforts that were undertaken to properly consider and calculate Medicare's interest. Examples include obtaining letters from treating physicians supporting the analysis and claimant education regarding the proper use and accounting of the MSA funds.

Perhaps fundamental to the MSA debate is to ensure a clear understanding that an MSA may not be necessary when future medical coverage is not being permanently settled or if the claimant's treating physician can support that no future injury-related care is necessary. "Medicare Secondary Payer – Workers' Compensation (WC) Frequently Asked Questions," question & answer No. 20 (April 22, 2003), *available at* www.cms.hhs.gov/WorkersCompAgencyServices (last visited August 17, 2009). "It is unnecessary for the individual to establish a set-aside arrangement for Medicare if all of the following are true: a) The facts of the case demonstrate that the injured individual is only being compensated for past medical expenses (i.e., for services furnished prior to the settlement); b) There is no evidence that the individual is attempting to maximize the other aspects of the settlement (e.g., the lost wages and disability portions of the settlement) to Medicare's detriment; and c) The individual's treating physicians conclude (in writing) that to a reasonable degree of medical certainty the individual will no longer require any Medicare-covered treatments related to the WC injury."

Liability settlements (and MSAs)

The fundamental statutory principle requiring settling parties to consider and protect Medicare's interest in WC settlements already exists and appears to apply to liability settlements as well. The Medicare Secondary Payer (MSP) provisions state Medicare is always secondary to WC and other insurance, including no-fault and liability insurance. 42 U.S.C. §§1302, 1395w-101 through 1395w-152, 1395hh (2000 & Supp. 2004); *see also* 42 C.F.R. §411.40. Again, under the Social Security Act, payment "*may not be made under Medicare for covered items or services to the extent that payment has been made, or can reasonably be expected to be made promptly, under a liability insurance policy or plan*." 42 U.S.C. §1395y(b)(2), *amended by* Pub. L. No. 109-171, 120 Stat. 4 (2006). Also, Medicare's authority to review liability settlements arises under the same statute as does its authority to review WC settlements. Social Security Act §1862, *as amended,* 42 U.S.C. §§1395y(b)(2), 1395y(b)(5)(d), 1395y(b)(6), *amended by* Pub. L. No. 109-171, 120 Stat. 4 (2006).

The MSA obligation in a liability settlement, however, is only clear (on its face) in the specific case where a definitive allocation for future injury-related medical expenses exists for an injured Medicare beneficiary. An example is a verdict sheet with a future medical expense line item or—albeit rare—a settlement release with a definitive allocation for future medical treatment, such as a surgery contemplated by the parties and specifically listed on the settlement documents to ensure no future liability exists for that specific line item expense. We further submit that certain large settlements wherein damage elements other than future medicals are capped (such as pain and suffering) or non-existent (such as other economic damages, like lost wages) may fit this same unique mold.

On the other hand, in the majority of settlements where the parties settle liability cases using a broad, general release of all damages and do not specify or otherwise allocate them, whether due to policy limitations or other confounding factors, the ability to determine the propriety of a MSA becomes much less clear. When settling a liability case in which payment for future medical expenses is not specifically negotiated, if a general release is implemented that uses broad language (for example, referring to "all claims past and future"), our current standard is to facilitate a damages/recovery "reasonable person" analysis to determine if a portion of the recovery definitively recognizes future injury-related care and then further determine the amount of future injury-related care for which Medicare would otherwise be responsible.

Our firm currently employs the reasonable person operating in good faith standard where liability settlements either (1) fall in the range of one million dollars or more, or (2) fall into those isolated, lower value cases where the settling parties acknowledge future medical expenses account for the majority of damages. In either case, the Garretson Firm Resolution Group, Inc. (GFRG) is frequently asked to provide an inde-

pendent evaluation of Medicare's future interest.

First and foremost, the analysis of any fact pattern must take place in light of the following context: At this time, there are no statutory requirements promulgating the use of MSAs, or any other vehicle, in liability settlements. In fact, the term "MSA" does not appear in any currently enacted statute and is nowhere defined in any currently enacted regulation. Nor—as discussed more fully below—is there any guidance from CMS. In fact, CMS, in town hall teleconferences related to the implementation of the Medicare, Medicaid and SCHIP Extension Act of 2007 (MMSEA), has told the legal community that CMS' routine recovery processes have not changed. For a specific example, one can look at the call transcript dated March 24, 2009. www.cms.hhs.gov/MandatoryInsRep/07_NGHP_Transcripts.asp#TopOfPage (last visited August 17, 2009). Here, we see that the set-aside process (whether it is for WC or liability) is: 1) voluntary, not mandatory, and 2) the same as it has been in the past. No new guidance has been issued by CMS mandating the use of MSAs in liability settlements.

The discussion regarding the use of an MSA in liability settlements has been borrowed from guidance received related specifically to WC settlements. Currently, there are 12 memoranda from CMS about the use of MSAs in WC settlements and zero memoranda about the use of MSAs in liability settlements. The reason for the guidance in the WC situations is that CMS is interpreting the MSP statute, namely 42 U.S.C. §1395y(b)(1). If CMS intended for MSAs to be used routinely in liability settlements, it would issue similar guidance specific to the use of MSAs in liability settlements.

Furthermore, when reviewing the regulations that interpret the Medicare Secondary Payer statute, it is relevant to note that remedies for failure to properly consider Medicare's past payments, as a function of its conditional payment reimbursement rights, include direct recovery against the third party (primary) payer, but nowhere in the statutes which address future medical expenses is there a similar recovery right against third parties. 42 C.F.R. §411.24(e). Instead, the nomenclature is couched in terms involving a loss of coverage for those beneficiaries. Where, then, is the defendant-directed liability for failure to use MSAs in settlements coming from? It is certainly not coming from statutes or from the regulations. Instead, it appears to be driven by other external settlement forces, which may have financial incentives to create a MSA requirement for liability settlements where none exists.

In sum, the standard to be applied to MSA analysis in liability settlements is "substantial compliance" grounded in good faith, appreciating the fact that there is neither a statutory requirement nor guidance for the use of MSAs in liability settlements. If, however, in good faith, a reasonable person would surmise that an actual allocation for future injury-related medical expenses exists in the settlement (which should be the exception and not the rule) such that the claimant voluntarily chooses to pursue a set aside arrangement, two options exist: i) identify the appropriate allocation and educate the claimant to ensure that those proceeds are spent down on future injury-related care (for which Medicare would otherwise pay), and/or ii) contact the appropriate Medicare regional office, share the fact pattern of the case and determine whether they elect to review and approve the allocation. The regional offices make these elections based on workload thresholds and are subject to change without notice.

The new MMSEA statute does not require MSAs

Despite considerable urban legend, the new MMSEA statute does not contain any new guidance or requirements related to MSAs. The MMSEA statute requires defendants/insurers to report certain information regarding settlements with Medicare beneficiaries to the Secretary of Health and Human Services. In fact, the sole purpose of Section 111 of the MMSEA is to ensure that settling parties fully comply with the Medicare Secondary Payer requirement—that is, past Medicare payments must be verified and resolved in all liability, workers' compensation and no-fault settlements. In this regard, if plaintiff's counsel is already verifying and resolving Medicare's reimbursement claim in all settlements, as far as MMSEA is concerned, it is business as usual for plaintiff's counsel and his/her clients. This new law (to date) has nothing to do with identifying Medicare-covered future costs of care, which leads to MSA issues and analysis. GFRG regularly updates the dedicated MMSEA section of its Web site. See www.garretsonfirm.com for further information regarding MMSEA and related practice tips.

As mentioned above, CMS has clarified in several recent town hall meetings that CMS' recovery practices have not changed on account of MMSEA. Furthermore, CMS has published several "user guides" and interpretative "alerts" and at no time have they stated that they intend to now require MSAs for liability settlements. For instance, *see* www.cms.hhs.gov/MandatoryInsRep/Downloads/RevisedSection111022309.pdf. "Unless you are a business entity which qualifies as [a required reporting entity (RRE)] for purposes of Section 111, you do not need to initiate any specific actions in connection with Section 111." *See also* www.cms.hhs.gov/MandatoryInsRep/Downloads/AlertToEmployers050609.pdf. "Section 111 information helps the Medicare program determine primary versus secondary payment responsibility. Section 111 requires that in certain situations, entities will electronically send health insurance benefit entitlement information." *See also* www.cms.hhs.gov/MandatoryInsRep/Downloads/RevisedSection111022309.pdf. "The new Section 111 requirements do not change or eliminate any existing obligations under the MSP statutory provisions or regulations."

Perhaps more persuasive to this point is the Congressional Research Service (CRS) analysis of the MMSEA statute. This comprehensive analysis of the new legislation (and its intent) does not mention, at any point, the concept of Medicare set-asides in liability cases. Certainly if such purpose

(*i.e.,* requiring MSAs in liability settlements) were part of the congressional intent of MMSEA, one would reasonably expect it would have been in the CRS analysis (after all it would be a rather notable revenue-generating component of such new law if it were a part of it).

Practical guidance

While the above is intended to help a personal injury practitioner sift through the misinformation and emerge with a better understanding of the appropriateness of MSAs, no analysis would be complete without a discussion of what to do if a settling party is misinformed and/or shares a differing opinion about such MSA-related law/guidance and is requiring that an injured plaintiff establish a MSA as a condition of settlement. (As we wrote in a recent practice tip, "We realize we all may be trying for some time—as cowboy wisdom goes—to stuff feathers into a pillowcase during a wind storm").

When confronted with such situations (and the injured plaintiff would still like to proceed with settlement), we have proceeded as follows:

- First, we have provided settling parties and their representatives with this white paper as well as a copy of a comprehensive article regarding MMSEA entitled, "Act II: Reporting Obligations for Settling Insurers where Medicare is a Secondary Payer: The Medicare, Medicaid and SCHIP Extension Act of 2007." [See www.garretsonfirm.com/garretson/news/index.cfm?newsID=13];
- Second, the Garretson Firm Resolution Group has provided an opinion letter that states our experience and qualifications in such matters as well as provides a fact-specific analysis of the case (i.e., analysis of the claimant's present or pending Medicare entitlement status; determination of the definitive (if any) future medical allocation in the settlement; analysis of the percentage of past v. future medicals reasonably associated with the allocation; analysis and documentation of the claimant's true future injury-related care requirements;
- Third, if the first two steps fail to carry the day, we have recommended that the plaintiffs agree to indemnification language in the settlement/release agreement with defendants that keeps the focus on the law and not the conjecture around Medicare compliance. In this regard, such indemnification language may state that plaintiffs will indemnify defendants from any and all injury-related obligations/Medicare rights (past, present or future) arising out of 42 U.S.C. §1395y(b)(2);
- Fourth, if a MSA is still being demanded as a condition of settlement, proceed with obtaining a MSA evaluation from a qualified Medicare Set Aside allocation provider and consider submitting such evaluation including a damages/recovery allocation performed by a qualified resource to the appropriate Medicare Regional Office. (It is quite possible the response received will be that the R.O. is not reviewing and approving such submissions in liability settlements.)

Finally, regardless of the outcome of the four steps above, we recommend always disclosing to the injured claimant the analysis above to ensure he/she is fully informed about why a MSA is or is not being established. An example of such a disclosure statement is contained in the booklet entitled "Medicare, Medicaid & Private Health Insurance Plans: Important Information about Healthcare Liens in Personal Injury Settlements," which can be accessed at www.garretsonfirm.com/garretson/resources/?pageID=49.

Conclusion

To be sure, the use of MSAs is a topic of great conversation nationwide. The debate gets slightly more complicated when considering the lack of any statutory requirement. While the legal community can follow guidance about how to use MSAs in WC settlements to properly consider Medicare's interest, no similar guidance exists about how to use MSAs in liability settlements. As a result, any entity professing that MSAs are now routinely required in all liability settlements absent: (1) a true good faith analysis, such as that discussed above, and (2) specific guidance published by CMS, and/or 3) a bill passed by Congress and signed into law regarding the use of MSAs in liability settlements is not providing sound advice and may, in fact, be improperly promoting a cost recovery mechanism that has no legal foundation.

This white paper is based on our firm's many years of experience with Medicare compliance issues. While our analysis is subject to interpretation, having specifically addressed this issue in both single event and mass tort settlement programs, we submit that until actual statutory guidance or any type of CMS guidance is provided, the question whether an MSA is required in liability settlements will be extremely fact-intensive, with the required elements leading to an affirmative answer being few and far between, as the majority of liability settlements do not include the same carve out for future medicals that WC settlements do.

We submit this white paper to assist settling parties with better understanding MSAs. At the same time, hopefully, we have provided some practical guidance/tips for dealing with situations where a settling party (perhaps misinformed about the related requirements [or lack thereof]) is demanding a MSA in a liability settlement.

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The Control of ESI

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The meaning of an age-old duty in an ever-advancing electronic world was recently clarified within the Fourth Circuit. *See Goodman*, *infra*. With the threat of spoliation sanctions looming over the unwary, it is critical to understand a party's pre-litigation duties, including the duty to preserve potentially relevant electronically stored information (ESI). Ill-advised clients and clients who have sought no advice until after the receipt of a summons and complaint may quickly find themselves at the mercy of the bench as their counselors try to explain why material ESI was not preserved back when litigation was first reasonably anticipated. The focus of this article is to understand the impact of the *Goodman* analysis in order to better advise clients as to what ESI is within their "control" and thus subject to their duty to preserve.

Six years after the first of the landmark opinions of Hon. Shira Scheindlin of the Southern District of New York in what are commonly known as *Zubulake I - VII*, which helped pave the way to the 2006 Amendments to the Federal Rules of Civil Procedure pertaining to ESI, courts and practitioners continue to iron out the details of litigants' responsibilities over ESI. The *Zubulake* decisions imposed severe sanctions on a party for failing to produce and ultimately to preserve ESI pursuant to a court order during the discovery process. *See e.g. Zubulake v. UBS Warburg LLC*, 229 F.R.D. 422, 424 (S.D.N.Y. 2004) (*Zubulake V*) (sanctions included: costs for re-deposing relevant witnesses, costs to restore backup tapes, attorneys fees associated with the motion and an adverse inference instruction to the jury). Similarly, other courts have imposed even greater monetary fines, including one to the tune of $8.5 million, and have even referred the attorneys involved to the California bar discipline authority for "intentionally hiding or recklessly ignoring relevant documents" that were electronically vstored. *Qualcomm Inc. v. Broadcom Corp.*, 2008 U.S. Dist. LEXIS 911 at *64 (S.D. Cal., Jan. 7, 2008). In light of these sanctions, we are all in need of clear guidelines to help assess our clients' duties to preserve ESI.

Interestingly enough, much helpful guidance comes from within our very own Fourth Circuit in addition to the Southern Districts of New York and California. In fact, the Fourth Circuit has contributed quite a bit to ESI case law thanks in large part to the writings of Hon. Paul Grimm, U.S. Magistrate Judge for the District of Maryland. Judge Grimm has opined extensively on the topic of e-discovery and ESI. *See e.g. Lorraine v. Markel Am. Ins. Co.*, 241 F.R.D. 534 (D. Md. 2007); *Victor Stanley, Inc. v. Creative Pipe, Inc.*, 250 F.R.D. 251 (D. Md. 2008). This summer, Judge Grimm added to his repertoire with *Goodman v. Praxair Servs.*, 632 F.Supp. 2d 494 (D. Md. 2009), which further articulates a much needed clarification of the test for determining a party's duty vel non to preserve ESI, especially that which they do not own.

While there are multiple factors of a spoliation analysis (including: the date the duty to preserve is triggered, the relevance of the evidence and the degree of culpability), the focus of this article is on whether or not potentially relevant ESI falls within the scope of the duty based on the potential litigant's control of the ESI. To this end, Judge Grimm recognizes that the Fourth Circuit has strong case law pertaining to the obligations of a party to preserve material evidence in the "non-ESI" context. *Id.*, *citing Silvestri v. GMC*, 271 F.3d 583 (4th Cir. Md. 2001). The *Silvestri* court announced with regards to the repair of a vehicle:

> If a party cannot fulfill [the] duty to preserve because he does not own or control the evidence, he still has an obligation to give the opposing party notice of access to the evidence or of the possible destruction of the evidence if the party anticipates litigation involving that evidence.

Goodman, 632 F.Supp. 2d at 514 (*quoting Silvestri*, 271 F.3d at 591). In *Silvestri*, the plaintiff had "access" to the vehicle and was held culpable for failing to advise the defendant of his access prior to the destruction of evidence, even though he could not "control" the destruction. *Id.*

Recognizing that ESI is a unique category of evidence, Judge Grimm analogizes an ESI case interpreting a party's duties under Rule 34 regarding "possession, custody, or control" to define "control" in the pre-litigation spoliation context before him. *Id.* (*citing Gordon Partners, et. al. v. Blumenthal (In re NTL, Inc. Sec. Litig.*), 244 F.R.D. 179 (S.D.N.Y. 2007)). He states:

> Rule 34 "control" would not require a party to have legal ownership or actual physical possession of any documents at issue. Instead, documents are considered to be under a party's control when that party has "the right, authority, or practical ability to obtain the documents from a non-party to the action."

Id. at 515 (*quoting In re NTL*, 244 F.R.D. at 194-95) (internal quotations omitted). According to Judge Grimm, this "legal authority" or "practical ability" test will determine whether or not a party has the requisite "control" over ESI such that it falls within their duty to preserve. *Id.* at 515-16. Very well, "what does 'legal authority' or 'practical ability' look like in real life?" you might ask. The facts of *In re NTL* are essentially that a defendant, who had recently emerged from bankruptcy proceedings as the successor corporation, objected to a Rule 34 request on the grounds that the requested ESI was not owned or controlled by it but rather by a separate entity, which had also emerged from the same bankruptcy proceedings. The court disagreed and held that the defendant "had both the legal right and the practical ability to obtain any documents in [the new entity's possession]" as evidenced by a "docu-

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What's Happening in Your Circuit?

First Judicial Circuit

YLD members of the of the First Judicial Circuit along with the Orangeburg County Bar hosted a **Happy Hour** at the Four Moons Restaurant in Orangeburg on December 10. This event was well attended, with more than 40 individuals from the two groups present.

T. Derrick Felder, First Circuit Representative of the Young Lawyers Division, and Robert N. Clariday, Vice President of the Orangeburg County Bar, coordinated the happy hour along with the cooperation of the Four Moons Restaurant.

Third Judicial Circuit

YLD members in the Third Judicial Circuit were invited to attend a **reception** on October 1. The event was held at the Tavern on Main in Sumter.

Fifth Judicial Circuit

On July 14, YLDers enjoyed a **Courthouse Keys Happy Hour** with the Hon. John E. Waites. The event was held at the Wild Wing Cafe in Columbia. A good time was had by all.

Members also had the pleasure of a **Courthouse Keys Breakfast** with Judge Alison R. Lee, Circuit Court Judge, At Large, Seat 11, in August in Columbia. Judge Lee shared many practical tips for balancing the practice of law with young lawyers. From motion hearings to trials, Judge Lee encouraged the young lawyers to always be prepared and not allow their nerves to overcome their ability to communicate effectively with the judge. Finally, Judge Lee emphasized the importance of having a balanced life which includes being a successful attorney, but also includes having time for important things such as family and friends. She truly shared words to live by!

On September 24, the YLD **Professional Development** Committee hosted its second annual **"Pre-Game" CLE** with the S.C. Association of Certified Public Accountants. This joint CLE was attended by approximately 50 young lawyers and young CPAs looking to learn more about common issues facing clients of both professions in this economy. The attendees learned important information about proper business records, avoiding personal liability, fiduciary duties, forensic accounting, recent tax updates and bankruptcy from the esteemed faculty. Please join us next year for the Third Annual CLE—we are working on a full-day program with a networking happy hour.

On November 19, the Committee hosted a **reception** for new admittees at the Carolina Field House in Columbia in conjunction with the Richland County Bar Association. More than 100 people attended the event. Special thanks to Bryan and Mary Caskey, Matt Bogan and Rebecca Roser for coordinating the event.

Seventh Judicial Circuit

On September 16, members of the Seventh Judicial Circuit were invited to a **reception** at Brasserie Ecosse in Spartanburg. Up to 30 young lawyers were in attendance with a strong showing from the solicitor's office. In addition to networking and catching up with classmates, Ryan Langley, Seventh Judicial Circuit Representative, discussed future plans for the upcoming year and introduced committee members.

The Seventh Circuit held its second social event of the year December 9 at the Spartanburg Country Club. Although it was a little cold and windy, there were close to 50 people in attendance. The event was a great opportunity to network with other attorneys in the area as well as to catch up with friends. In addition to the piles of oysters, there was also an open bar and a fire pit. As the evening neared an end, everyone gathered inside to learn a little bit more about Protecting Our Youth. This program's mission is to serve the South Carolina school system, teachers, juveniles, parents and the community by informing students about the consequences of harmful behavior and encouraging students to be successful. Thanks to all who attended the event.

Ninth Judicial Circuit

On June 11, the **Courthouse Keys** Committee organized an event for young lawyers to meet the Hon. Kristi Lea Harrington. The event was held at Music Man BBQ in Moncks Corner, and 21 young lawyers from the Ninth Circuit attended. Judge Harrington, along with Mary Brown, Clerk of Court for Berkeley County, personally spoke with all of the attorneys in attendance. Among other topics, Judge Harrington discussed her perspective from the bench and her transition from assistant solicitor to judge. Thanks to Judge Harrington and Ms. Brown for taking time out of their busy schedules to meet YLD members. The committee looks forward to another event with them in the future.

13th Judicial Circuit

On July 7, the 13th Judicial Circuit hosted the **Fourth Annual Pub Olympics** at the Corner Pocket Tavern. The Pub Olympics is a friendly competition among summer law clerks in pub games such as pool, darts and foozball. Each team has

four clerks, and no more than one clerk from a law firm is on a team to help make connections between the participants. For 2009, 32 summer law clerks participated, and the winning team secured a $50 gift certificate. Numerous young lawyers came out to cheer on the clerks.

A new admittee **reception** was hosted in conjunction with the Greenville Young Lawyers Club on November 19. The event was held at the home of Judge D. Garrison Hill in Greenville.

14th Judicial Circuit

A **wills clinic** was held on August 21 at the Beaufort County Sheriff's Department in Beaufort.

16th Judicial Circuit

Members in the 16th Judicial Circuit were invited to attend a **reception** on October 29 at the City Club in Rock Hill. Attendees were asked to bring one bag of candy to be given to the York County DSS for Halloween.

CONTINUED FROM PAGE 6

ment sharing clause." *Id.* at 515 (*quoting In re NTL*, 244 F.R.D. at 195-96). The fact that the defendant could seek any document it needed from the non-party pursuant to a specific agreement to do so was enough for the court to hold that the defendant likewise must produce any such available documents pursuant to their Rule 34 obligations.

In the spoliation context of *Gordon*, the defendant had not made any attempt to preserve documents prepared and maintained by one of its environmental consultants who was assisting with certain EPA qualifications/exemptions and who the plaintiff alleged was the defendant's agent (i.e., under the defendant's "control"). Judge Grimm disagrees with the plaintiff and determines that the record is void of any evidence to suggest the defendant had "the sufficient legal authority or practical ability to ensure the preservation of documents prepared by [their consultant] ... or that would demonstrate a relationship between them "comparable to the cooperative, file-sharing relationship between [the Defendant and the non-party] from *In re NTL*." *Id.* at 515.

Similarly, another District of Maryland case recently held that the appearance of and the information on a defendant's Web site fell within its duty to preserve. *Nutramax Labs., Inc. v. Theodosakis*, 2009 U.S. Dist. LEXIS 77182 (D. Md. June 8, 2009). Applying the *Goodman* analysis of "legal authority" or "practical ability," this duty would exist even in situations where a company's Web site is maintained by a third-party.

The *Goodman* case makes excellent progress in clarifying how ESI ought to be treated in the spoliation context. Hopefully, the Fourth Circuit will adopt this approach for determining whether ESI is within one's "control" (i.e., within its legal authority or practical ability) thereby assisting practitioners in understanding and advising clients on the duty to preserve in the ESI realm. The next and more challenging step will be to determine how the "access" mentioned in *Silvestri* should be defined in the ESI spoliation context, which is not to be confused with the great body of case law expounding on "reasonably accessible" ESI within the context of Rule 26(b)(2)(B).

Until then, we should advise our clients to suspend routine data destruction and to implement a litigation hold on all ESI within their legal authority or practical ability to control immediately upon reasonably anticipating litigation, while being mindful that even where they merely have access to additional ESI, they should notify adversaries of any potential destruction by others.

Young Lawyers Division Receives ABA Award for Families Forever Adoption Project

The South Carolina Bar Young Lawyers Division (YLD) was recognized as the recipient of the American Bar Association (ABA) Young Lawyers Division's Most Outstanding Public Service Award for its Families Forever service project at the ABA Annual Meeting in Chicago.

Chaired by N. Charleston lawyer and past president of YLD Tiffany Spann-Wilder, the Families Forever project focuses on adoption awareness throughout the state. Family Fairs were held in Columbia, Charleston and Greenville last year to encourage and educate families on foster care and the adoption process, both domestic and international, whether through the S.C. Department of Social Services, an adoption agency or through private arrangements. As a result of this project, at least 10 children have been placed in homes, including a family of five children. YLD plans to continue the project this year with fairs in Greenville and Charleston. For additional information regarding this project, please visit www.scbar.org/adoption.

Two other YLD projects that received special recognition included the YLD Leadership Academy, chaired by S. Venus Poe, and Mothers in the Law: Balancing Family and Work, chaired by Amy Hill. In addition, the Division received second place for the comprehensive program. For additional information on the ABA Awards of Achievement, please visit www.abanet.org/yld/awards/aoa.

Bar Bits

Operation Christmas Stocking
The Done-in-a-Day Committee coordinated efforts with the South Carolina Chapters of the Blue Star Mothers of America, Inc. to collect nonperishable items such as snacks and personal care items to be packaged and sent to troops stationed overseas. The items were collected by volunteers at several drop-off sites throughout the Midlands. The Committee successfully completed its efforts on November 19 by delivering and packaging donated items at the VFW in Lexington County. The packages were shipped and received by the troops in time for Christmas. These contributions would not have been possible without the hard work of the Done-in-a-Day Committee members, YLD volunteers and the S.C. Blue Star Mothers.

Backpack Drive
The Done-in-a-Day Committee coordinated efforts with The Cooperative Ministry and WIS News to donate new backpacks and school supplies to various children's homes and youth advocacy programs throughout the Midlands. The Committee successfully completed the Backpack Drive on August 14 by organizing and delivering nearly 200 backpacks stocked with paper, notebooks, folders, pens, pencils and other school supplies. The Cooperative Ministry reported many of the backpacks and supplies were immediately distributed to a group of students in need. This would not have been possible without the hard work of the Done-in-a-Day Committee members, participating circuit representatives, YLD volunteers and The Cooperative Ministry.

YLD Recognizes Domestic Violence Awareness Month
In recognition of Domestic Violence Awareness Month in October, the Division's Voices Against Violence Committee, chaired by Ginny Waller, kicked off its efforts for the 2009-10 year with a Necessities and Paper Products Drive. The Committee collected more than $2500 in monetary donations as well as personal care items for battered women's shelters throughout South Carolina. Thanks to Richardson, Patrick, Westbrook & Brickman, LLC, S.C. Legal Services, Sexual Trauma Services of the Midlands, Nexsen Pruet, LLC, The Law Firm of Bacot & Padgett, LLC, Rosen, Rosen & Hagood, Rogers Townsend & Thomas and the Housing Authority of the City of Charleston for their donations and participation in the drives. Join us in 2010 as we take it to the next level and donate our handiwork to refurbish domestic violence shelters.

The Committee also hosted a CLE on January 8 at the Sumter County Library. *Domestic Violence: What Every Attorney Should Know* addressed both civil and criminal aspects of domestic violence representation, as well as ethical considerations. This CLE qualified for 6.75 MCLE credit hours (.75 ethics). Attendance was FREE; however, all attendees committed to representing two pro bono clients in Order of Protection actions.

Ginny Waller Named Outstanding Victim Service Provider of the Year
On April 30, the S.C. Victim's Assistance Network awarded STSM Executive Director Ginny Waller the Outstanding Victim Service Provider Award at its 22nd Annual Victim's Rights Week in Greenville. This award is given to a direct service provider who goes above and beyond the call of duty to assist crime victims.

FY2010-11 Nominations

The Young Lawyers Division Nominating Committee met on November 11, 2009, to consider all nominees and make nominations by majority vote for the offices of President-Elect, Secretary-Treasurer and even-numbered Judicial Circuit Representatives for the 2010-11 Bar year. The following slate was approved:

Office	Name
President:	Tina N. Herbert
President-Elect:	Rebecca A. Roser
Secretary-Treasurer:	Floyd S. Mills III (Trey)
Immediate Past President:	Fred W. Suggs IIII (Trey)
Out-of-State Representative:	vacant
Second Judicial Circuit Representative:	Sydney J. Lynn
Fourth Judicial Circuit Representative:	T. Brooke Hunt
Sixth Judicial Circuit Representative:	Jamie L. Walters
Eighth Judicial Circuit Representative:	Thomas E. Hite III
10th Judicial Circuit Representative:	T. Matthew Bradley
12th Judicial Circuit Representative:	FitzLee McEachin
14th Judicial Circuit Representative:	Tyler A. Melnick
16th Judicial Circuit Representative:	Tracy T. Vann

Foreclosures and Loan Modifications: Stopping the Flood After the Storm

Katie McElveen • Richardson, Patrick, Westbrook & Brickman, LLC, Mt. Pleasant
Mark Fessler • S.C. Legal Services, Greenville

A flood of foreclosures

Over the past two years, the rate of foreclosure filings in the United States has exploded. "U.S. foreclosure filings spiked by more than 81% in 2008, a record, according to a report released [in January 2009], and they're up 225% compared with 2006." Foreclosures Up a Record 81% in 2008 (Jan. 15, 2009), *available at* www.money.cnn.com/2009/01/15/real_estate/millions_in_foreclosure/index.htm?postversion=2009011503 (last visited Oct. 20, 2009). The number of foreclosures reported in 2008 is staggering. "A total of 861,664 families lost their homes to foreclosure last year, according to RealtyTrac, which released its year-end report [in January 2009]." *Id.* "There were more than 3.1 million foreclosure filings issued during 2008, which means that one of every 54 households received a notice last year." *Id.*

The national foreclosure statistics for the end of 2008 and the first quarter of 2009 remain distressing, especially in the face of the foreclosure moratoria put in place from November 26, 2008, through January 31, 2009, by Fannie Mae, Freddie Mac and some other major lenders and loan servicers in attempt to slow down the flood of foreclosures. "Foreclosure filings were up 17% in December over November, and rose 41% compared with December of 2007." *Id.* In the first quarter of 2009, statistics from data gathered by the HOPE Now Alliance (HOPE) estimated that 5.39 percent of all loans nationally were 60-plus days delinquent, up from 2.47 percent for loans throughout 2007. *Id.* HOPE NOW is an alliance between counselors, investors, mortgage companies and other market participants. The entity, sponsored by the Department of Housing and Urban Development, routinely collects data and estimates that its data collection efforts canvass approximately 72.9 percent of the mortgage industry. Unfortunately, the State of South Carolina has not escaped the foreclosure crisis. In South Carolina, loans two payments past due rose from approximately 25,000 in the third quarter of 2006 to over 35,000 through the third quarter of 2008. South Carolina Foreclosures: Impact and Opportunities, The Center for Responsible Lending (Jan. 2009), *available at* www.responsiblelending.org/mortgage-lending/tools-resources/factsheets/sc-foreclosure-fact-sheet.pdf (last visited Oct. 20, 2009).

Predatory lending practices and nontraditional loan products

While there are differing opinions as to what has caused the mortgage crisis, most financial experts agree that this crisis has been fueled, in part, by the predatory practices of some lenders, costing borrowers tens of billions of dollars each year. According to a report issued in June 2006 by the Office of the Inspector General for the Federal Deposit Insurance Corporation (FDIC), "Predatory lending typically involves imposing unfair and abusive loan terms on borrowers, and statistics show that borrowers lose more than $25 billion annually due to predatory practices." Office of Inspector General, Challenges and FDIC Efforts Related to Predatory Lending, June 2006, Report No. 06-011, *available at* www.fdicoig.gov/reports06/06-011.pdf (last visited Oct. 20, 2009).

While there is no set definition of "predatory lending," some agencies have provided characteristics and warning signs to aid consumers in recognizing potential predatory lending practices. The FDIC noted four characteristics that can be associated with predatory lending. These characteristics include, but are not limited to: "(1) abusive collection practices, (2) balloon payments with unrealistic repayment terms, (3) equity stripping associated with repeated refinancing and excessive fees, and (4) excessive interest rates that may involve steering a borrower to a higher-cost loan." *Id.* The Center for Responsible Lending has provided the following list of common warning signs for consumers: excessive fees; prepayment penalties; inflated interest rates from brokers (yield-spread premiums); steering and targeting; adjustable interest rates that "explode"; promises to fix problems with future refinances; not counting taxes and insurance; and repeated refinances that drain your resources. 8 Signs of Predatory Lending, *available at* www.responsiblelending.org/mortgage-lending/tools-resources/8-signs-of-predatory-lending.html (last visited Oct. 20, 2009).

Some loan products exude characteristics of predatory lending due to the very nature of the product itself. For example, a "balloon" payment mortgage is not fully amortized over the life of the loan, leaving a balance due at the maturity date. This type of loan typically requires a borrower to pay a large, lump-sum payment on the maturity date. Because a typical borrower cannot afford to pay this lump-sum, many balloon payment mortgages have a "recast" option. A recast option may permit a borrower to recast the loan balance at current rates to a fully amortized payment schedule. However, the recast option is not always available to borrowers and depends on such things as the borrower's payment history and the existence of any property liens. If the recast option is not a possibility, then a borrower may have no choice but to attempt to refinance the remaining balance of the loan, leading to increased risks, as the borrower may be unable to refinance the debt owed.

Another particularly volatile loan product that has caused a swell of defaults and foreclosures is the payment-option adjustable rate mortgage (option ARM). The option ARM "might be the riskiest and most complicated home loan product ever created." Nightmare Mortgages (Sept. 11, 2006), *available at* www.businessweek.com/magazine/content/06_37/b4000001.htm (last visited Oct. 20, 2009). This *BusinessWeek* article contains a link to the "Map of Misery"—a state-by-state map illustrating the percentage of new and refinanced mortgages into loans with payment options. *See* www.businessweek.com/common_ssi/map_of_misery.htm (last visited Oct. 20, 2009). The option ARM product was originally created in the early 1980s for particularly wealthy individuals who "wanted the option of making low payments most months and then paying off a big chunk all at once." *See* www.businessweek.com/magazine/content/06_37/b4000001.htm. However, during the housing boom of 2004 to 2005, lenders began selling these loans to typical consumers, relying on soaring home prices as a "safety net" of sorts. Betting on the continued increase of home prices has proven catastrophic, especially in light of the number of option ARM loans sold during this time period. Indeed, the vast number of option ARM loans sold mandated a revision of the Consumer Handbook on Adjustable-Rate Mortgages (known as the "CHARM") by the Federal Reserve Board to include information on these loans. A December 2006 press release from the Federal Reserve Board stated, "In recognition of the growing use of nontraditional mortgage products that allow borrowers to defer payment of principal and sometimes interest, the agencies have substantially revised the CHARM booklet to include discussions about 'interest-only' and 'payment option' mortgages." *See* www.federalreserve.gov/newsevents/press/bcreg/20061226a.htm (last visited Oct. 20, 2009). A copy of the updated CHARM is located at www.federalreserve.gov/pubs/arms/armsbrochure.pdf (last visited Oct. 20, 2009).

The option ARM is a mortgage with an interest rate that adjusts with the market. Borrowers are typically given four payment options—a "minimum" payment, an "interest-only" payment, an amortized payment based on a 30-year loan term, and an amortized payment based on a 15-year loan term.

When selling these loans to borrowers, lenders often focused only on the minimum payment option, touting the product's "low payment" as a way for consumers to save money and "free up cash flow" for retirement savings, paying down high-interest debt, and funding college tuition. Unfortunately, often to the consumer's surprise, the "low" payment did not pay down any of the principal balance and only covered a portion of the interest accruing on a monthly basis. The remainder of the unpaid interest was tacked on the principal balance of the loan, causing the balance to increase each month. This increase in the original principal balance is known as "negative amortization."

The inclusion of a monthly "payment cap" caused negative amortization to occur more rapidly. The payment cap would only allow the monthly payment a borrower was making to increase at a small rate each month, usually 7.5 percent of the preceding month even if the interest rate was increasing at a higher rate, and even when a homeowner owed more than originally borrowed. To make matters worse, these loans usually contained steep penalties for early payment, effectively preventing borrowers from refinancing.

The loans also contained a recasting feature. Once the original loan balance increased to a certain amount due to negative amortization, usually 125 percent of the original balance, the loan would automatically reset. When the loan reset, the borrower was no longer permitted to make the "minimum" payment. The new payment amount that the borrower was required to pay was an amortized payment typically based on a 30-year loan term using the new, increased principal balance, and was often more than double the amount the borrower was previously paying on a monthly basis.

"There was plenty more going on behind the scenes [consumers] didn't know about, either: that their broker was paid more to sell option ARMs than other mortgages; that their lender is allowed to claim the full monthly payment as revenue on its books even when borrowers choose to pay much less; that the loan's interest rates and up-front fees might not have been set by their bank but rather by a hedge fund; and that they'll soon be confronted with the choice of coughing up higher payments or coughing up their home." *See* www.businessweek.com/magazine/content/06_37/b4000001.htm. "The option ARM is 'like the neutron bomb,' says George McCarthy, a housing economist at New York's Ford Foundation. 'It's going to kill all the people but leave the houses standing.'" *Id.* A recent article published in the *New York Times* relays a story of a consumer who purchased an option ARM loan and discusses the skyrocketing default and foreclosure rates of option ARM loans compared to typical subprime mortgages. Loans that Looked Easy Pose Threat to Recovery (Aug. 26, 2009), *available at* www.nytimes.com/2009/08/27/us/27arms.html?_r=3&ref=business (last visited Oct. 20, 2009).

Over the past two years, the option ARM loans taken out in 2004 and 2005 have been resetting at alarming rates, sticking homeowners with payments they can no longer afford. "'The next wave (of foreclosures) is coming [in 2009] and in 2010, and that is primarily due to these pay-option ARMs and the five-year, adjustable-rate hybrid ARMs that are coming up for reset,' says William Longbrake, retired vice chairman of Washington Mutual." 'Pay option' mortgages could swell foreclosures (Dec. 10, 2008), www.msnbc.msn.com/id/28035238/ (last visited Oct. 20, 2009). "'It's going to get tougher to modify loans as these option ARMs come into their resets,' Federal Deposit Insurance Corp. Chairwoman Sheila Bair stated." *Id.* The option ARM loans are "more difficult than the subprime and traditional adjustable rates to modify because there is such a huge payment differential when they reset." *Id.* Mr. Todd Jadlos, managing director of LPS Applied Analytics, a company that analyzes data for the financial industry, stated, "By the time subprime defaults had increased 200 percent, in June and July of 2007, option ARMs had gone up 400 percent." *See* www.nytimes.com/2009/08/27/us/27arms.html?_r=3&ref=business.

The government responds

To respond to the rising tide of national foreclosures spawned in large part by option ARM and other nontraditional mortgage loan products, Congress threw up a number of legislative sandbags. One such was Public Law 110-343 (October 3, 2008), better known the Emergency Economic Stabilization Act of 2008 (Act of 2008). The Act of 2008 provided authorization and funding for a number of efforts intended to stave off or mitigate the ongoing economic collapse. Congress addressed illiquidity in the credit markets due to non-performing residential and commercial mortgages and mortgage-derivatives under Title I of the Act by creating a Troubled Asset Relief Program (TARP) and allocating $250 billion immediately, with up to $700 billion total, to purchase or otherwise address the declining value of these "troubled" mortgage assets. Public Law 110-343, §§ 101, *et seq.* (Oct. 3, 2008).

Two sections of the TARP legislation foreshadowed what would become the Making Home Affordable Program (MHAP). *Id.* at §§ 109 and 110. Section 109 of Title I, entitled "Foreclosure Mitigation Efforts," authorized the Secretary of the Treasury to "implement a plan that seeks to maximize assistance for homeowners …" *Id.* The statute further authorized the Secretary to encourage the servicers of the underlying mortgage loans to use "available programs" to minimize foreclosures.

Within a month after President Barack Obama's inauguration, the Treasury, on February 18, 2009, released certain details of the President's Homeowner Affordability and Stability Plan (Plan). *See* U.S. Treasury press release tg-33 (Feb. 18, 2009), *available at* www.treasury.gov/press/releases/tg33.htm (last visited Oct. 4, 2009). The press release for the Plan described three points of emphasis, the first being a mortgage loan refinance program, the second a mortgage loan modification program, and the third a general statement of purpose about the Treasury's intent to continue supporting Fannie Mae and Freddie Mac, the two government-sponsored entities that had become symbols of the collapse of the subprime mortgage industry. *Id.* Of the three Plan points, the modification program garnered the most excitement, and on March 4, the Treasury officially implemented the modification program under the now ubiquitous name "Making Home Affordable." *See* U.S. Treasury press release tg-48 (March 4, 2009), *available at* www.ustreas.gov/press/releases/tg48.htm (last visited Oct. 4, 2009).

The Plan and its two programs aim to help borrowers reduce their mortgage payments and avoid foreclosure by providing affordable and stable mortgage payments. The Plan constitutes the most direct attempt to date to infuse capital directly into individual non-performing residential mortgage loans, to refinance or modify the terms of these mortgage loans, and thus prevent home foreclosures from further destabilizing the crumbling U.S. housing market. Ultimately, the Treasury projects that the Plan will help seven to nine million delinquent or nearly delinquent borrowers retain homeownership before the Plan's programs expire.

The two programs that constitute Making Home Affordable are now known as the Home Affordable Refinance Program and the Home Affordable Modification Program (HAMP). The refinance program allows certain borrowers who meet narrow eligibility criteria to take advantage of current low interest rates by providing a low-cost refinance intended to reduce monthly housing costs to sustainable levels. This program is limited in scope to loans owned either by Freddie Mac or Fannie Mae. However, the Treasury Department estimates that this program will aid four to five million homeowners before it wraps up in June 2010.

The HAMP, however, expects to

modify mortgages for three to four million homeowners before it is scheduled to end on December 31, 2012. This article focuses on the Modification Program. It has the potential to reach the broadest type of borrower because, unlike the Refinance Program, is not limited to loans owned directly by the Federal National Mortgage Association (Fannie Mae) and Federal Home Loan Mortgage Corporation (Freddie Mac). This program offers mortgage loan servicers incentives to voluntarily modify the terms of loans to bring monthly payments down to sustainable levels. This program has received commitments from Treasury to provide up to $75 billion to help borrowers avoid foreclosure. *See* Statement of Neil Barofsky, Special Inspector General for the Troubled Asset Relief Program, to the Senate Committee on Banking, Housing, and Urban Affairs, p. 3, (Sept. 24, 2009), *available at* www.docstoc.com/docs/11958503/SIGTARP-Testimony-9-24-09_Final_4_ (last visited Oct. 4, 2009). Fifty billion of this sum is slated to come from funds allocated under TARP, and if the program performs as intended, it should, consistent with the overriding purpose of TARP, transform non-performing mortgage loans from toxic assets into non-toxic financial products that an investor might purchase. *Id.*

The modification program is relatively ambitious considering past industry standards and practice when renegotiating delinquent loans. Although a loan modification alters certain terms of the existing agreement, a loan modification does not result in a reduction of the monthly payment unless specifically targeted to do so. *See generally* Crews, Amy C. and Merrill, William A., Interventions in Mortgage Default: Policies and Practices to Prevent Home Loss and Lower Costs, Freddie Mac Working Paper 08-01, (2008), *available at* www.freddiemac.com/news/pdf/interventions_in_mortgage_default.pdf (last visited Sept. 6, 2009). Unless the loan servicer offers the at-risk borrower either a rate reduction, an extension of the loan term, a reduction in the principal balance, or a combination of the three, the monthly payment actually will increase. The effect of such a measure, whether applied to an option-ARM loan or other loan type, often is to make an unaffordable payment even more so. Common sense suggests that a loan modification that does not increase affordability will not turn a non-performing loan into a reliable one. But one group of researchers, reviewing datasets of renegotiated home mortgages since 2007, concluded that only about three percent of seriously delinquent loans received modifications that actually reduced the monthly payment amount. Adelino, Manuel, Gerardi, Kristopher, and Willen, Paul S., Why Don't Lenders Renegotiate More Home Mortgages? Redefaults, Self-Cures, and Securitization, Federal Reserve Public Policy Paper 09-4 (2009), *available at* www.bos.frb.org/economic/ppdp/2009/ppdp0904.pdf (last visited Sept. 6, 2009).

On the other hand, HAMP targets affordability and sustainability as it seeks to decrease the monthly percentage of income that borrowers pay out for housing costs. To that end, the program pays incentives to loan servicers incentives that offer payment-reducing loan modifications with Freddie Mac and Fannie Mae, creating a two-tier scale that pays larger incentives for loan modifications that meaningfully reduce monthly payments. *See* Fannie Mae Announcement 09-05R, p.30 (offering additional payments to servicers if modification results in monthly payment reduction of six percent or more), *available at* www.efanniemae.com/sf/guides/ssg/annltrs/pdf/2009/0905.pdf (last visited Oct. 4, 2009); and Freddie Mac Single-Family Seller/Servicer Guide, vol. II, C65-39 (limiting incentive payments for modifications that only capitalize arrearage without using interest rate reductions or other modification features), *available at* www.freddiemac.com/sell/guide/bulletins/ (last visited Oct. 4, 2009). The HAMP program further allocates incentives to cover costs associated with underwriting the modifications, and it pays lenders to help offset the reduced cash flow stemming from reducing monthly payments on first lien loans to an amount approximately equal to 31 percent of a borrower's gross monthly income. Finally, it rewards servicers and borrowers for successful loan performance post-modification.

To date, the Treasury has issued six Supplemental Directives (Directives) that provide more specific detail to servicers implementing the HAMP as well as borrowers who are trying to assess their own eligibility for the program. Directive 09-01 largely establishes specific guidelines that borrowers and their attorneys can use to negotiate the modification process. This Directive designated, broadly speaking, a two-step process for determining whether a modification will be offered under the program. For a full description of eligibility and underwriting requirements, see Supplemental Directive 09-01, *available at* www.hmpadmin.com/portal/programs/directives.html (last visited Sept. 6, 2009). Under the first step, the servicer reviews threshold eligibility criteria, while during the second step, the servicer actually underwrites the loan modification.

The threshold eligibility criteria are straightforward. Most borrowers applying for HAMP will have little difficulty showing that they are eligible. Perhaps the most important eligibility criterion is that a borrower's monthly payment of principal, interest, taxes and insurance (PITIA) must be more than 31 percent of gross monthly income. If a borrower meets all eligibility requirements, the servicer must then process the modification using the following "standard waterfall." First, loan servicers participating in the Program should reduce interest rates down to a floor of two percent. If this does not achieve the target payment, the next step requires an extension in the term of the loan up to 40 years. Finally, if the borrower's payment still remains above the 31 percent target, the loan servicer is supposed to forbear loan principal to the end of the loan term. Any amounts deferred will be held in a non-interest bearing balloon payment that is due when the loan is refinanced or paid off.

One feature of HAMP is the trial period whereby the borrower makes three monthly payments before the

modification becomes permanent. The trial period immediately transforms a non-performing loan into one generating at least some positive cash flow. Additionally, the three-month period gives loan servicers time to manually underwrite and document all aspects of the modification to ensure that the modification will work and to weed out, to the extent possible, fraud and abuse in the program.

The HAMP guidelines make the program especially desirable for most non-conventional mortgage products for at least two reasons. Borrowers whose mortgage loan balances are now greater than the underlying value of their homes are not able to refinance into current lower interest rates, even under the Home Affordable Refinance Program. Thus, a Home Affordable modification likely is the best or only option available to borrowers with unconventional loan types that will allow them to remain in their homes. First, HAMP can lower interest rates for five years and fix them permanently, thereby providing predictability and certainty. This effect will allow borrowers to plan their monthly expenses to match income without worrying that their house payments will increase with each interest rate adjustment.

In addition to creating predictable costs, HAMP also provides a second boon to borrowers with unconventional loans through its emphasis on affordable payments. The typical option-ARM, for example, only allows the borrower to select a monthly payment until the loan hits the negative equity threshold. At that point, the loan agreement requires it to become amortizing. As previously mentioned, this requires the monthly payments to rise to a level that will amortize the loan over the remaining life of the loan. At that point, the borrower not only owes more on his home than it is worth, he also must pay more per month to actually begin to pay down the loan principal. HAMP is designed to attempt to alleviate this burden, making the program a welcome relief for borrowers with expensive and unpredictable loan terms.

Current status of the modification results

Results for HAMP modifications have been sparse to date because the program is relatively new. If one were to judge HAMP solely in terms of servicer participation, one would assume that it should easily meet its goal of three to four million modifications. As of October 4, 2009, 63 servicers, representing well over 80 percent of all eligible mortgages, had signed "Participation Agreements" with the U.S. Treasury to offer HAMP modifications to eligible borrowers. *See* Making Home Affordable Program: Servicer Performance Report Through August 2009, *available at* www.financialstability.gov/docs/MHA-Public_090909.pdf (last visited Oct. 5, 2009). The most recent numbers to come out of the U.S. Treasury Department were released on October 8. *See* Treasury publication TG-315 (Oct. 8, 2009), *available at* www.treasury.gov/press/releases/tg315.htm (last visited Oct. 20, 2009). As of that date, 500,000 trial periods had been started, which was up from the 360,000 trial period starts announced previously on September 9. *See* Treasury press release TG-280 (Sept. 9, 2009), *available at* www.ustreas.gov/press/releases/tg280.htm (last visited Oct. 20, 2009).

On the other hand, HOPE surveys that tracked loan modifications from January 2007-July 2009 indicate a surprising trend. By the first quarter of 2009, loan modifications had begun to increase dramatically from 2007 levels. For example, modifications for subprime loans totaled less than 20,000 for July 2007, yet by February 2009, that figure had risen more than 500 percent, while prime loan modifications rose approximately 250 percent for the same period. *See* supra, note 7, at 12-13. By the first quarter in 2009, total completed loan modifications had risen well above 100,000, but the second quarter of 2009, the quarter immediately following the launch of HAMP, saw completed modifications pull back below the 100,000 mark. *See* supra, note 7, at 12-13. One possible explanation for this could be the mandatory three-month trial period that precedes the ultimate modification, and if trial period starts are any indication of the ultimate tally for completed modifications, one can expect this total to easily surpass previous highs. But until figures tracking permanent modifications begin showing up in reports, the few currently available statistics will not provide a crystal clear picture of HAMP's effectiveness.

Assuming that all, or even most, of these trial modifications become permanent, it should help alleviate the growing rate of foreclosures throughout South Carolina. Figures compiled by S.C. Court Administration show statewide foreclosures through June 2009 on track to exceed 2008 foreclosures by about four percent—approximately 30,383 for 2008 v. 16,368 through June 2009. The counties that experienced the worst foreclosure rates were Horry County followed by Greenville, Charleston and Richland counties. A recent review of figures from the popular real estate database RealtyTrac comparing homes in foreclosure to units of housing, shows Beaufort, Dorchester and Richland counties topping the list. As of October 5, 2009, these counties had one out of every 253, 340 and 394 housing units in foreclosure, respectively. *See* www.realtytrac.com/trendcenter/default.aspx?address=SC (last visited Oct. 5, 2009).

Other possible ways to avoid foreclosure

Borrowers turned down for HAMP by loan servicers and served with a foreclosure suit are not out of options. One key defense to foreclosure actions comes from Chief Justice Jean Toal's Administrative Order 2009-22-01-1 (Order). In Re: Mortgage Foreclosures and the Home Affordable Modification Program (HMP), Administrative Order 2009-22-01-1, *available at* www.judicial.state.sc.us/courtOrders/displayOrder.cfm?orderNo=2009-05-22-01 (last visited Oct. 12, 2009). The Order requires all plaintiffs in foreclosure actions initiated after May 4, 2009, to provide in the complaint "a short plain statement of the facts regarding the applicability of HMP to the matter." A defendant can challenge the HAMP allegation, at which time the issue must be decided like any other con-

tested issue of fact. If HAMP applies, whether determined by consent of the parties or by the judge, the Order stays the foreclosure action until the HAMP process can be completed.

Borrowers without defenses to foreclosure actions or borrowers who desire to press counterclaims should investigate and consider potential defenses or claims for violations of the Truth in Lending Act, the Real Estate Settlement Procedures Act, the South Carolina Unfair Trade Practices Act, and the South Carolina Consumer Protection Code, as well as possible causes of action for breach of contract and the implied covenant of good faith and fair dealing, fraudulent omission, fraudulent concealment, and a host of other statutory and common law claims.

For example, under South Carolina law, borrowers should analyze the presence of liability under Chapter 23 of the Consumer Protection Code (CPC). Chapter 23 was drafted and passed in 2003 and became effective January 1, 2004. Although most of the CPC exempts first lien mortgages from the activities it sanctions, Chapter 23 created tort liability for a practice called "loan flipping." Section 37-23-20(8) defines flipping a home loan to be the making of a loan that refinances a previous loan when the new loan gives the borrower no reasonable, tangible net benefit. However, the loan refinanced must have originated within the last 42 months. The statute calls for a comparison of the terms of the new and old loan as well as consideration of the cost of the new loan and other circumstances of the borrower.

The statutes establishing the flipping action set up a few barriers for borrowers trying to prove a case. For example, the definition of flipping itself enumerates seven possible benefits to a borrower that, if proven by the lender, create a rebuttable presumption that the borrower did in fact receive a net benefit and that the loan was not a flip. If the lender cannot show one of the seven enumerated benefits, the statute allows the lender to articulate other benefits received by a borrower in order to obtain the protection of presumption. Another caveat favorable to the lender is that the borrower must show that the lender acted knowingly or intentionally, not just negligently. On the other hand, the statutes authorize significant possible recovery and other remedies for the borrower who proves his claim. Not only can the borrower recover actual damages, a statutory penalty also is available. Furthermore, if the offense is so egregious that a court decides the case in the borrower's favor as a matter of law, the court can award the entire amount of the loan finance charge and allow the borrower to repay the loan without any finance charge, which effectively means the borrower avoids all interest payments. Additionally, the court can refuse to enforce the agreement, selectively enforce it or rewrite the agreement. Finally, the statute of limitations for a flipping action is one of its most useful attributes. Most state or federal laws that create causes of action for aggrieved mortgage borrowers have statutory limitation periods of one or three years. Most of these causes of action accrue at the time the mortgage loan is closed, and the borrower who finds himself faced with a foreclosure suit also often finds himself outside the limitations period for many possible counterclaims. Fortunately, the loan flipping statute sets a limitations period of six years, which means that borrowers who have had loans flipped are more likely to be able to assert this claim in a foreclosure action.

Apart from the CPC, an opinion issued by the U.S. District Court for the District of South Carolina in 2008 validated one of the borrowers' TILA claims and allowed a claim for breach of contract and the implied covenant of good faith and fair dealing to proceed. In *Mincey v. Wachovia Corp.*, district court granted in part plaintiffs' cross-motion for judgment on the pleadings in a case involving an option ARM loan. The plaintiffs alleged that Wachovia violated the Truth in Lending Act in disclosing negative amortization as a mere possibility when it was, in fact, certain to occur if consumers followed the payment schedule provided by the defendant. The court granted "Plaintiffs' Motion for Judgment on the Pleadings with respect to the claim that WSB violated the TILA by disclosing negative amortization was a possibility when in fact it was a certainty." 614 F. Supp. 2d 610, 638 (D.S.C. 2008). This case has been transferred by the Judicial Panel on Multidistrict Litigation to the Northern District of California.

The district court also denied defendant's motion to dismiss plaintiff's claim for breach of contract and the implied covenant of good faith and fair dealing. Plaintiffs alleged that the defendant breached the loan agreement by applying their payments to only a portion of the interest. In allowing the plaintiff's claims to go forward, the court reasoned, "Plaintiffs demonstrate that the loan contract states, 'I will pay Principal and interest by making a payment every month.' (Complaint 24:15-16.) This could easily be understood to mean that, if Plaintiffs made payments every month, their payments would be applied to both principal and interest. Plaintiffs have alleged that they were led to understand the contract in that way, and that the Defendants breached that contract. Thus, Plaintiffs have sufficiently alleged that the terms of the contract were ambiguous." *Mincey*, 614 F. Supp. 2d 610 at 647.

Conclusion

Looking forward to 2010, foreclosure rates do not appear to be subsiding, and with unemployment not expected to peak until the middle of 2010, there is no reason to expect foreclosure trends to return to pre-2008 levels anytime soon. *See, eg,* Zibel, Alan, "Foreclosures rise 5 percent from summer to fall," Associated Press, Oct. 15, 2009, *available at* http://hosted.ap.org/dynamic/stories/U/US_FORECLOSURE_RATES?SITE=AP&SECTION=HOME&TEMPLATE=DEFAULT (last visited Oct. 17, 2009). Nevertheless, between HAMP, Justice Toal's Order and the variety of claims and defenses available to borrowers under state and federal law, borrowers and their attorneys can, with some promise, seek to avoid foreclosure while taking action against predatory and other illegal lending practices.

Protecting Our Youth

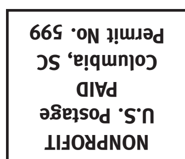
Fred W. Suggs III • Roe, Cassidy, Coates & Price, PA, Greenville

As the incoming president of the Young Lawyers Division of the South Carolina Bar, I had the opportunity to implement a program that would define "my year." Considering the Division's function as the service arm of the Bar, I desperately wanted to develop a program that would have a true impact on our South Carolina communities and the public at large. Namely, I wanted to create a program that could positively affect the lives of our young people. From this desire, Protecting Our Youth was born.

Protecting Our Youth was designed to educate at-risk high school students on the juvenile justice system and the risks associated with committing crimes as teenagers. I believe that our youth would not make the poor decisions that they so often make if they truly appreciated the potential impact of crime on their own lives and futures. Many teenagers do not appreciate the fact that the company they keep can dictate their direction, not just while teenagers, but for the rest of their lives. Many young people do not realize that certain crimes can result in their being prosecuted as adults, rather than children, and that they could potentially find themselves middle-aged and just reentering society after dozens of years of incarceration.

Because 2009 was the program's inaugural year, we limited the program to the four largest metropolitan areas of South Carolina: Greenville, Columbia, Florence and Charleston. In these communities, we organized panels of speakers, consisting of solicitors, criminal defense attorneys, family court judges and other interested attorneys, to conduct panel discussions with groups of high school freshmen ranging in number from 40 to 150. The panel members typically described their respective roles in the judicial system and then highlighted subjects or issues they felt were particularly pertinent. Examples of these issues included conspiracy ("the hand of one is the hand of all"), felony DUI and "sexting." Following the individual presentations, the floor was open to the students to ask questions of the panel.

Thus far, the program has been a great success. In fact, one of the principals at a Greenville high school was so impressed with our panel that he has suggested that, in the future, we speak to the entire student body. Of course, a program like this could not be possible without volunteers willing to sacrifice their time and offer their knowledge and experience in the hopes that we can influence these students. As Greenville defense attorney Frank Eppes explained, "I will speak to these kids every single week of the year even if I only make a difference with just one kid." We as attorneys have an obligation to our communities and our youth to endeavor to improve their lot in life. Protecting Our Youth is a start.



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