SERVICING MANAGEMENT®

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Field Services Introduce Compliance Concerns

Whether a lender will be held liable for the acts of its contractor is a fact-specific determination that can go either way.

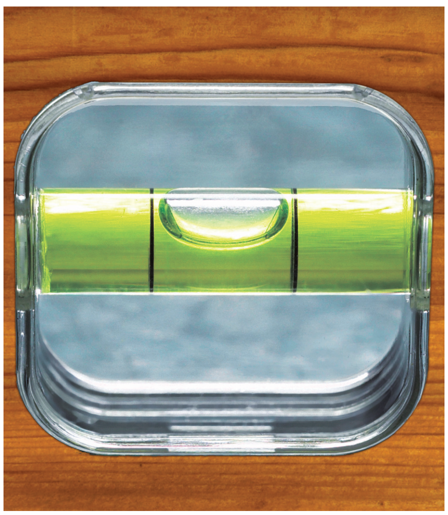
by Jonathan W. Cannon

The rising tide of residential foreclosures has thrown field services into the limelight and focused attention on the risks that field-service vendors can create for lenders and loan servicers. The foreclosure spike has brought new providers into the field, some of which have little or no previous experience working with regulated financial services businesses. Field-service companies range from large national corporations managing thousands of properties to mom-and-pop maintenance and construction crews handling local inspections, cleanup and repairs. Whatever their size, these firms are often an overlooked component of servicing - that is, until something goes wrong.

With nearly 2 million foreclosures annually in 2008 and 2009 and even more predicted for this year, field-service providers - inspectors, landscapers, locksmiths, trash-out vendors and the like - are playing an ever-increasing role in asset management operations. However, the compliance hurdles and risks these providers can create for servicers are not entirely understood. Some of these risks are explored in this article, with risk avoidance recommendations.

Servicer liability

Every attempt should be made by the servicer to select quality providers and routinely monitor their work - references, judgment searches and credit checks can help eliminate questionable vendors and those with reputations for poor work. Pre-employment due diligence is vital - property preservation should not be outsourced to "friends of friends" or those without appropriate experience and established track records. Even when vendors are carefully chosen, the servicer may receive complaints about them from homeowners. Field-service vendors may trespass, harass, offend or injure homeowners or others while performing their duties, or they may act outside the scope of their contracted duties.



The legal theory underlying a homeowner's claims against his lender for the acts of the property-preservation vendor is the law of principal and agent. Under this theory, the principal (lender) may be liable for the acts of its agent (vendor) if the agent performs its duties under the control of the principal and within the scope of its assignment.

The most straightforward way to avoid principal/agent liability is for the parties to contract with each other as independent contractors, disclaiming any principal/agent relationship. Independent contractors are generally absolved from liability for each other's wrongful acts. Even where the lender/vendor contract establishes the parties as independent contractors, the homeowner may make claims against the lender for the vendor's acts, because the lender will be perceived as having deeper pockets, and the homeowner's relationship with the lender is typically more significant and long-standing than any relationship he has with the vendor.

Whether a lender will be held liable for the acts of its independent contractor is a fact-specific determination that can go either way. The parties' contract is not necessarily the deciding factor. Moreover, even if a contract expressly states that the parties are independent contractors, the course of their dealings could result in a finding that they acted as principal and agent.

Cases imposing lender liability for vendors' wrongful acts include Wells Fargo v. Tyson (New York Supreme Court, 2010), where the lender was held liable for damages based on an inspector's trespass, and Countrywide Home Loans Inc. v. Thitchener (Nevada, 2008), where the lender was held liable for more than $900,000 in punitive damages when its vendor provided trash-out services on the wrong property while the homeowner was out of town on military duty.

As stated already, one of the best defenses to principal-and-agent liability is a good offense: screening and training pro-

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viders. Second, quality-control reviews should be made of the providers' job performance to determine if they meet the lender's standards. Complaint logs should be indexed by provider name, enabling monitoring of patterns of complaints involving specific vendors.

Occasional quality-control inspections can be useful, as is requiring vendors to maintain surety and fidelity bonds and reasonable amounts of liability insurance. Where substantial work is contracted to a specific company, contracts should include indemnification provisions to protect the lender against losses and judgments (including legal defense costs), and the lender should periodically review the vendor's financial situation to check its ability to meet its indemnification obligations.

Vendor qualifications

With estimates that nearly one-third of all homes currently for sale are foreclosures, lenders have to work hard to attract potential buyers. One way some lenders do this is by rehabilitating properties in their real estate owned (REO) inventories to make them more appealing. Some studies show that the time on market for remodeled properties is significantly reduced compared to unrenovated homes. This is the sort of statistic that leads servicers to undertake construction projects rather than simple post-foreclosure property protection. Field-service vendors may offer construction and rehab services in addition to inspection, lock-up and winterizing, and servicers may find it convenient to have a single provider for both types of work.

Construction trades are often subject to licensing or bonding under local laws, and failure to have required licenses or bonds can backfire on the servicer if there are problems with the construction job. There may be a fine line between casual repairs that can be done by a field-service vendor and more complex repairs that require a building permit. Only experienced builders and contractors may be able to discern the difference. A municipal "stop work" order based on failure to obtain a required building permit can mean valuable time lost on the market and money fines to the property owner. Moreover, compliance with local building and rehabilitation codes is essential - servicers must screen contractors to ensure that they are up-to-date on local rules. Code violations can lead to orders to remove the improvements or to undo the work.

To avoid these problems, the lender should carefully identify the vendor's responsibilities and ensure any rehab and construction work is performed by qualified vendors with the right personnel, licenses and permits. When in doubt, the lender should consult an independent source for guidance, rather than rely on the field-service provider's assurances. The greater the amount of work undertaken or the more complex the type of work, the more important it is that the vendor have the appropriate personnel, liability insurance and financial stability. For example, substituting a handyman for a qualified electrician undoubtedly involves more risk to the property owner than using a handyman for interior painting or lawn cutting.

Job completion

In the 15 years since Martha Rodash successfully sued to rescind her mortgage based on a $22 Federal Express charge not included in the loan's finance charge, residential lenders have been constantly challenged on the types and amounts of fees they charge. With loan originations down and foreclosures up, servicing-related fees are under new scrutiny. Servicers engaging field-service providers run the risk that fees might be charged for services that are not fully performed.

Courts have taken servicers to task for passing fees on to borrowers for work that could not be substantiated. In one case, the bankruptcy court disallowed charges for some of the nine broker price opinions (BPOs) the servicer claimed it performed when the lender could produce only two of the reports. Without evidence that the rest of the work was performed, the court declined to require the borrower to pay for it. The same court also rejected the servicer's claim for payment of property-inspection reports that appeared to have gone unread. Even if the work is done, if it is irrelevant or ignored, a case may be made that no fee is appropriate.

Some types of services must be performed or the lender may have liability for nonperformance. For example, a lender may be fined for failing to perform property maintenance. The large amount of REOs has led many localities to adopt ordinances that require lenders to maintain their vacant and abandoned properties. Failure to keep the grass cut and the snow shoveled, for example, can lead to punitive fines of up to $1,000 per day in some locales. In this situation, the lender, not the vendor, would be responsible for the fines. The lender should be vigilant about keeping up-to-date on local property maintenance ordinances and require its vendors to do the same. Vendor contracts can be written to put the burden of complying with local property-maintenance ordinances on the field-service companies. Companies unable or unwilling to assume this burden may, in effect, be saying they are unconcerned with or ill-prepared to assume compliance responsibilities - a red flag for their lender customers.

When a loan goes into default and property-preservation services are ordered, the borrower ultimately pays the cost for the services. Despite footing the bill, the borrower cannot shop for a provider or control the prices. While there are few, if any, specific restrictions on fees that can be charged for inspections, snow removal, lock changing and similar services, state attorneys general or the Federal Trade Commission may disfavor fees that appear excessive, unfair or above-market, especially when the borrower is captive to the servicer's choice of providers. The risk of a claim of price unfairness may be heightened if the field-service provider is an affiliate of the servicer.

However, it is not necessarily true that affiliate-provided services must be priced lower than third-party services. Some courts agree that a servicer may provide default services through an affiliate, even if the affiliate does not offer the lowest possible cost. In the Ohio case of Webb v. Chase Manhattan Mortgage Corp., the court allowed the servicer to provide force-placed insurance through an affiliate, but noted that the servicer had provided ample warning to the borrower about the costs of the insurance. In another case, the court found that "[u]sing an affiliated [field service] company conceivably could reduce transaction costs and increase efficiency, to the consumer's benefit."

To minimize risk when using affili-

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ated default-services vendors, lenders should adopt policies to disclose to borrowers that affiliates will be used and consider disclosing their affiliates' charges. Obviously, the lender and its affiliates must avoid kickbacks to each other for the business between them and provide services at rates that are reasonable within the market for similar services. Contracts between servicers and their affiliated default-services providers should be documented as thoroughly as contracts with third-party vendors and contain the same type of financial and liability protections.

Servicers sometimes ask their lawyers whether their field-service providers are debt collectors, because debt collection is such a highly specialized and regulated field. Most debt collectors are subject to state and federal laws that restrict the specifics of their collection-related conduct. Although the loan servicer is the principal party for consumer contact and payment collection, a field-service provider may operate in a gray area on the fringes of collection agency laws.

For instance, property-preservation representatives sometimes speak with delinquent borrowers during property inspections or work-related visits, or they may talk to others living in the home, or to neighbors, to learn where the borrower is. The property-preservation employee may leave a door hanger on the premises, urging the borrower to contact the servicer. While these activities may not sound like debt collection, under certain laws and judicial interpretations, this conduct may cross the line into debt collection.

Courts are split on what types of activities constitute debt collection. For example, in Bailey v. Security National Servicing Corp., the court found that a letter to a consumer that "demands nothing" is not communication subject to the FDCPA. On the other hand, other courts have found that messages that do not mention specific information about a debt may still be subject to the FDCPA.

Servicers should adopt informed policies concerning what their default vendors may and may not say to borrowers, family members or others in the home, and require their vendors to have basic knowledge of the FDCPA. If the vendor is a small company or lacks a compliance or legal staff, the lender may even consider providing its own training to the vendor, or paying for the vendor's training.

When properly selected and managed, and working under carefully crafted contracts that define both parties' responsibilities and limit their liabilities to each other, field-services companies play an essential role in preventing property waste, aiding lenders' recovery of loan proceeds and protecting REO assets. With more loans going into default and more homes going into foreclosure, the activities of these providers will come under increased scrutiny. Now is the time for lenders to re-evaluate their vendor relationships, making changes where necessary and implementing quality-control mechanisms. SM

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