# *Mortgage Settlement Or Mortgage Shakedown?*

**By David Skeel**

The $25 billion mortgage settlement negotiated on Feb. 9 by the administration and 49 state attorneys general with five big banks has been greeted with considerable political suspicion. Conservatives see a shakedown and liberals dismiss it as too little. The biggest loser is the rule of law.

The government plaintiffs allege that the banks, which were the largest mortgage servicers during the real-estate bubble, used foreclosure documents that had been "robo-signed" by executives who hadn't bothered to check the details. They also claimed these institutions—Bank of America, Citigroup, J.P. Morgan Chase, Wells Fargo and Ally Financial—added unnecessary fees such as overpriced insurance.

Under the settlement, the banks agreed to provide roughly $17 billion in loan modifications and $3 billion in refinancing relief that liberal critics note may never happen. Actual foreclosed borrowers get $1.5 billion in cash, and $3.5 billion in cash gets passed on to state and federal governments for unspecified consumer-protection and foreclosure programs.

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This settlement amounts to a legislative program—it isn't the result of a real lawsuit at all. In a real lawsuit, lawyers investigate the grievance in question, and if they persuade the court that their client has been harmed, the court or jury awards relief that is designed to remedy the harm, and perhaps to deter violations in the future. The chief objectives of the judicial process are fact finding and redress.

**If big banks are to cough up billions, shouldn't the money have something to do with the harms alleged?**

But in this case the attorneys general do not seem to have done any meaningful investigation. Instead of interviewing witnesses and reviewing documents, they treated the case as an opportunity for photo-ops and high-level negotiations. The settlement terms have little to do with the allegations. Only a small number of the robo-signed documents seem to have involved borrowers capable of paying their mortgages. The vast majority of the money changing hands has nothing to do with robo-signing or unnecessary fees.

By way of contrast, consider then-New York Attorney General Eliot Spitzer, who in 2003 used his sweeping powers under the state's Martin Act to corral the largest investment banks into a $1.4 billion settlement and to institute reforms to remove perceived conflicts of interest in the investment banking industry. And the state attorneys general wrested a $250 billion settlement from the tobacco industry in 1998.

These settlements were and are highly controversial. But whatever one thinks of Mr. Spitzer's headline-grabbing investigations of Merrill Lynch and other banks, no one would suggest he didn't check his facts. Mr. Spitzer and his lieutenants subpoenaed years of emails and documents, and they interviewed dozens of bankers. And while the allegations in the tobacco settlement were hotly debated, the terms of the settlement were directly linked to the alleged harms.

The new mortgage settlement, however, is an effort to provide an additional economic "stimulus" to housing without going to Congress. Most of the money may go to homeowners in some form, and there is also a multibillion-dollar handout to cash-strapped states.

Throughout the financial crisis, starting with the bailouts of Bear Stearns and AIG, and continuing with the auto bailouts, the government has assumed that normal rules and restrictions, not to mention constitutional checks and balances, don't matter. So far it has prevailed, but at considerable cost. By cutting corners to achieve desired ends, government intervention has created clouds of uncertainty that will linger long after the crisis has passed.

A new study by finance professors Bradley Blaylock, Alexander Edwards and Jared Stanfied (published at ssrn.com) found that companies in highly unionized industries in the year after the 2008-09 Chrysler bailout had to pay a higher interest rate than companies in other industries, and they experienced sharp declines in the value of their existing debt.

It isn't too late to uphold the rule of law. Because the mortgage settlement calls for injunctive relief, its terms still must be approved by an actual court, and courts increasingly have refused to bless dubious settlements. Federal judge Jed Rakoff has tossed out several Securities and Exchange Commission settlements. And when Larry Ellison proposed to settle insider-trading litigation by making a contribution to a charity a few years ago, the initial settlement was rejected partly because the contribution had nothing to do with Oracle or its shareholders.

The same logic applies here. When the mortgage settlement is presented to a court for its blessing, the court should reject it.

*Mr. Skeel is a law professor at the University of Pennsylvania.*