ROUNDTABLE ARTICLE

CMBA Fall Roundtable

Mortgage Litigation

EDITOR'S NOTE — *This is the ninth in a series dealing with the issues facing the real estate finance industry. Each issue we touch on a different topic, asking CMBA's experts for their thoughts on the issue at hand. In this issue of CMFN, we look at a topic that will be discussed in further detail at CMBA's upcoming Annual Western States Legislative, Regulatory, QA & Compliance Conference, December 5 in Costa Mesa. CMBA asked three different experts for their thoughts and opinions on the latest in mortgage litigation.* ***Michael Pfeifer*** *is the managing partner at Pfeifer & DeLaMora, LLP, a member of the CMBA Board of Directors, and a nationally recognized expert in the areas of lender liability defense litigation, financial fraud investigation and recovery, regulatory compliance, and creditor representation in bankruptcy. Pfeifer is also the chair of CMBA's National Policy Committee, CMBA's Mortgage Quality & Compliance Committee and is the chair of the upcoming conference.* ***Eric Houser*** *is the president/shareholder of Houser & Allison, APC. He has extensive litigation experience representing financial institutions and other creditors both in state, federal and Bankruptcy Courts. Finally,* ***Andrew Noble*** *is an associate with Severson & Werson, specializing in commercial litigation with an emphasis on consumer class actions and financial institution litigation. As always, the opinions expressed by the participants are those of the participants only, and are not necessarily those of their respective companies.*

1. What tactics are private litigants using to delay or forestall foreclosure?

Houser: Private litigants continually bring claims alleging either procedural defects in the foreclosure process or disputing the role of MERS in the foreclosure process. These issues often serve as the basis for a variety of causes of action asserted by borrowers ranging from fraud to negligence to unlawful business practices. Some litigants also claim that they were promised a forbearance or loan modification that was breached by the lender/servicer. The typical strategy employed by borrowers is to file a lawsuit alleging one or more of these claims just before the foreclosure sale and then immediately seek an *ex parte* restraining order to enjoin the sale.

Noble: The focus of foreclosure-delay litigation has definitely changed during the past few years. Early on we saw a lot of cases challenging loan terms and representations made in the course of the origination, often by brokers. Almost all of these claims have expired under the applicable statutes of limitations, although that doesn't necessarily stop borrowers from trying.

The trend now is lawsuits arising from "loss mitigation" services provided to defaulted borrowers. In these cases, the borrowers contend that the lender/servicer promised a loan modification or other forbearance event. Any written promise to "consider you for a permanent modification" or "modify the terms of your loan" at the conclusion of a forbearance period invites litigation by an unhappy borrower who is convinced that he or she qualifies but was denied the modification.

One constant theme we've seen in foreclosure-delay cases is the allegation that the lender lacks "standing" to foreclose. Several years ago lenders were inundated with "produce the note" cases in which the borrowers alleged that the lender could not foreclose without producing the original promissory note. We are seeing fewer of these cases following the critical *Gomes v. Countrywide Home Loans, Inc. (2011) 192 Cal.App.4th 1149* opinion, in which the Court of Appeal held that California's non-judicial foreclosure regime does not require a judicial proceeding to determine ownership of the note.

Pfeifer: Although the theories sometimes differ, private litigants almost always seek a temporary restraining order and preliminary injunction to stay the foreclosure pending the outcome of their lawsuit. If that fails, they usually seek bankruptcy protection to further delay the process.

Since foreclosure involves title or the right to possession of real property, most, but not all, will usually

CONTINUED ON PAGE 16

CMBA Regional Networking Series

'San Diego After Hours'

January 19, 2012 | 5:00-7:00 p.m.
Offices of Kimball, Tirey & St. John, LLP

A FREE networking event for residential real estate finance pros!

Featuring: Q&A with
Professor Ryan Ratcliff
University of San Diego

Register Now at www.CMBA.com!

Sponsored by:

THE LAW OFFICES OF
Kimball, Tirey & St. John LLP

Would your company like to host/sponsor one of CMBA's new regional networking events happening in your area?

Email Susan@cmba.com or call (916) 446-7100 for more info!

ROUNDTABLE ARTICLE CONTINUED FROM PAGE 9

file and record a Notice of Pendency of Action (*lis pendens*) against the property to give constructive notice of their claims to any prospective foreclosure bidder if injunctive relief is denied. These are not easy to expunge, so recording a *lis pendens* often postpones the need to file bankruptcy.

Early complaints asserted claims based on alleged violation of the disclosure obligations in the Truth in Lending Act ("TILA") or even the Real Estate Settlement Procedures Act ("RESPA"), even though RESPA does not provide a private right of action for disclosure violations. These cases were easily defeated on their face or on statute of limitations grounds.

More recent complaints are more sophisticated and mount challenges based on "standing" or lack of authority of the lender or servicer to authorize foreclosure. "Standing" arguments run the gamut from claims that MERS is not a valid beneficiary, to complex challenges to the various assignments made during securitization of a loan. Most complaints now also include allegations of some purported misconduct by the persons involved in the servicing or foreclosure process; e.g., the so-called "robo-signing" of notices and/or declarations by people without actual personal knowledge or authority to do so.

Some are also asserting creative claims of outright fraud by the original lender for supposedly inducing the borrower to purchase property the lender knew the borrower could not

CONTINUED ON PAGE 17

ROUNDTABLE ARTICLE CONTINUED FROM PAGE 16

afford, or otherwise incur obligations the consequences of which they could not reasonably have understood. Almost always, there is also a claim asserting some kind of "unfair and/or deceptive" acts or practices under Business and Professions Code §17200 in making or servicing the loan, including purported violation of Civil Code §2923.5 requiring contact with the borrower prior to recording a notice of default.

2. How can lenders/servicers best prepare themselves for such tactics?

Noble: Almost all lenders have expanded their loss mitigation departments--adding personnel, increasing training, etc. Still, more work can be done.

One good practice that will help limit foreclosure-delay lawsuits is make sure that employees communicating with borrowers carefully document what is said, when it is said, and how it was said.

Lenders should caution against off-script comments that "you will probably qualify for a loan modification" or something similar. Once a borrower believes that he or she is entitled to a modification a lawsuit will often follow.

Lenders should take particular care to assure that any promise to postpone an imminent foreclosure sale is followed by a clear communication to the trustee to put the sale over. Lenders should likewise caution against anything that could possibly be regarded as a promise to put over the sale. Ideally, all communications regarding this issue should be in writing and kept in the borrower's files.

Given the steep rise in forbearance/modification-related lawsuits, lenders would do well to remove any ambiguity from these loss mitigation agreements. If a permanent modification will be provided at the successful completion of the forbearance period, the details of the modification should be set forth in the agreement.

Pfeifer: As always, the best defense to an attack is strict compliance with applicable statutes and rules, coupled with robust policies and procedures and thorough documentation of compliance with them. This, in turn, requires employing sufficient personnel to maintain such compliance and training them properly, as well as careful selection and management of third party vendors. Investors have even begun auditing servicers to insure compliance, with servicers, in turn, auditing their vendors. While this presents new financial challenges, the investment is well worthwhile.

Some organizations have even created special teams of employees trained to respond to foreclosure lawsuits. These people become familiar with the company's record-keeping practices and systems and become skilled in testifying as witnesses and providing necessary information in response to requests for information from outside counsel. An excellent template for improving servicing and foreclosure operations can be found in the servicing consent orders issued in April by the OCC in connection with the so-called "robo-signing" scandal. A copy of these orders entitled "Interagency Review of Foreclosure Policies and Practices" can be found on the OCC website at: http://www.occ.treas.gov/news-issuances/news-releases/2011/nr-occ-2011-47a.pdf.

Houser: The California Courts have done a good job of detailing the procedural requirements to conduct a non-judicial foreclosure sale. Maintaining systems to ensure compliance with California procedure is a necessity to avoid borrower's delay tactics. Detailed records are also important to help defeat the injunctions sought by borrowers to delay the foreclosure sale. For example, Civil Code § 2923.5 requires contact with the borrower to explore workout options prior to recording a notice of default. Records detailing this loan workout contact will help to defeat the injunction and allow the sale to proceed in its normal course. Detailed loan records, including call recordings between the borrower and servicer/lender, also help to overcome false accusations that a loan modification or other representation was not complied with. It is also important that lenders/servicers utilize competent litigation counsel to defend against the numerous claims by private litigants in a cost effective and successful manner. Often times the firms that primarily handle routine evictions, foreclosure or bankruptcy matters are not equipped to handle the fast paced and demanding nature of litigation.

CONTINUED ON PAGE 20

ROUNDTABLE ARTICLE CONTINUED FROM PAGE 17

3. What are the most important cases either pending or likely to come up in the next 12 months?

Pfeifer: We can expect continued challenges to 'standing' based on the complex chain of ownership interests created by the securitization process, including more litigation involving MERS, notwithstanding a series of recent favorable decisions. We can also expect foreclosure challenges based on increased scrutiny of actual compliance with procedural requirements for servicing and foreclosure processing, as well as of the methods used by lenders, servicers, and their vendors to authenticate and document the existence of defaults and satisfaction of statutory requirements, including whether persons signing documentation had personal knowledge and authority to do so. It is also expected that borrowers and their counsel will try to claim some kind of beneficial interest in the servicing consent orders issued in April by the OCC (supra).

Under those orders, the 14 servicers involved are required to mail letters to eligible borrowers that explain how to request a review of their case if they believe they suffered financial injury as a result of errors, misrepresentations, or other deficiencies in foreclosure proceedings related to their primary residence between January 1, 2009 and December 31, 2010. That process will be a powerful engine for generating private litigation.

Finally, revenue shortfalls are likely to drive more aggressive enforcement efforts by counties and municipalities to "crack down" on "unfair" servicing and/or foreclosure practices where it appears that political or financial capital can be gained by doing so. While these activities will not directly involve borrowers, they can benefit them indirectly by creating stays of the foreclosure process and providing new arguments for private litigation.

Houser: The California Appellate Courts have come out in 2011 with some good decisions that have cut through various arguments being made by borrowers. For example, borrower's arguments complaining about the timing of the recording of the assignment and the role of MERS were dismissed by the California Court of Appeal in *Calvo v. HSBC Bank USA, N.A.*[1] The *Calvo* court affirmed that Civil Code § 2932.5 applies only to mortgages, not deeds of trust, and that California law does not require an assignment of deed of trust to be recorded prior to initiating foreclosure proceedings. In *Calvo*, the Court also ruled that both the express language of the deed of trust and Civil Code § 2924 provide legal authority for MERS to foreclose. The Court in *Robinson v. Countrywide Home Loans, Inc.*[2], similarly held that borrowers may not bring a preemptive suit challenging MERS's standing to foreclose. In *Fontenot v. Wells Fargo Bank, N.A.*[3], the Court rejected the borrower's claim that MERS lacked authority to assign the promissory note and held that MERS, as an agent for the lender, has authority to exercise all rights and obligations of a beneficiary under the deed of trust. Finally, both the Federal Ninth Circuit Court of Appeal in *Cervantes*[4] and the MERS MDL Federal Court[5] recently upheld the validity of the MERS system and ruled that the mere use of MERS does not cause a "splitting" of the note from the deed of trust barring non-judicial foreclosure. In 2011, the courts recognize that these arguments have no impact on the borrowers' obligations under their loan contract. These cases support the growing position in California that the courts will not allow borrowers to delay the process with novel arguments.

Noble: Case law in this area is still developing, and not every published decision has been favorable.

In *Aceves v U.S. Bank N.A.*[6], the borrower alleged that he was verbally encouraged not to file for bankruptcy protection so that a potential modification could be worked out. The Court found that such an allegation was sufficient to sustain a claim past the pleadings stage in that case. Undoubtedly, some borrowers will try to shoehorn their cases into the Aceves fact pattern to try to delay foreclosure.

There is substantive, active litigation (still) over the "standing" a servicer must show in order to foreclose. The California Court of Appeal has consistently taken the lender's position on most of these matters. The Court seems to understand that these lawsuits do not reflect a legitimate grievance, but are merely designed to create additional requirements for a nonjudicial foreclosure sale.

Creative plaintiffs' attorneys are still searching for chinks in the armor, and many are challenging the validity

CONTINUED ON PAGE 24

CALIFORNIA MORTGAGE BANKERS ASSOCIATION
555 Capitol Mall, Suite 440
Sacramento, CA 95814

ROUNDTABLE ARTICLE CONTINUED FROM PAGE 20

of the recorded foreclosure documents. Rather than argue that the lender lacks possession of the original promissory note, they now allege that recorded foreclosure documents are ineffective because they were not executed by the "true" beneficiary. The Court of Appeal gave some limited credence to this theory in *Herrera v. Deutsche Bank Nat. Trust Co.*[7]

We anticipate that the Court of Appeal or Supreme Court will address these claims in one or more opinion in the coming year. It is hoped that the appellate courts will decisively reject the "documents are not what they appear" claim once and for all.

1 *199 Cal. App. 4th 118 (2011)*
2 *199 Cal. App. 4th 42 (2011)*
3 *198 Cal. App. 4th 256 (2011)*
4 Cervantes v. Countrywide Home Loans, Inc., *656 F.3d 1034 (9th Cir. 2011)*
5 In re MERS MDL, *No. 2:09-md-2119 (D. Ariz. Oct. 3, 2011)*
6 *192 Cal. App. 4th 218 (2011)*
7 *196 Cal. App. 4th 1366. (2011)*

Have you updated your Membership Directory listing?

One of the benefits of your CMBA membership is inclusion in our online Membership Directory – make sure your company's info is up to date! E-mail Dustin@cmba.com for more information!

DELINQUENCY SURVEY CONTINUED FROM PAGE 10

Commercial Real Estate Consultant.

The following table compares delinquencies by type of property.

For survey purposes, a loan is considered delinquent if it is two or more payments past due. Loans in the process of foreclosure are included, regardless of the number of payments past due.

Sixteen income property mortgage bankers participated in the CMBA survey. These companies originate and service loans on apartments, retail, industrial and other commercial properties for institutional investors such as life insurance companies and pension funds.