

# Client Alert.

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## California Is Poised to Enact Foreclosure Legislation

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As California goes, so goes the nation? Let's hope not, at least as to legislation that will make California the first state in the nation to codify provisions of the National Mortgage Settlement. The new provisions will affect all entities that conduct more than 175 foreclosures a year in California. The Assembly and the Senate passed identical bills, and Governor Brown is expected to sign the measure into law today.

Underlying these requirements is a fundamental shift in the obligations of the mortgage servicer, which will include providing a "meaningful opportunity" for borrowers to be considered for loan modifications and other "foreclosure prevention alternatives." The law imposes additional notice requirements, prohibits dual tracking and robo-signing, and regulates the loan modification process. It also exposes servicers, foreclosure trustees, and beneficiaries to very large penalties and payment of attorney's fees for material violations of the new provisions.

The law will become effective on January 1, 2013 and includes sunset provisions as of January 1, 2018. However, many of the obligations will continue beyond that date due to separate, mirror-image provisions included in the law that take effect when the prior provisions expire.

### IMPACT ON MORTGAGE SERVICERS

- **Longer, more complicated foreclosure process.** By adding significant new procedures to the non-judicial foreclosure process, the legislation will only further delay non-judicial foreclosures in California, which took about a year on average in 2011.<sup>1</sup>
- **Bounty for trial lawyers.** The private right of action and possibility of recovering attorney's fees creates a win/win for trial lawyers. Lenders do have good lines of defense. Although materiality is not defined in the statute, it should be interpreted in the context of the purpose of the statute, which is to ensure borrowers have an opportunity to pursue foreclosure alternatives before the foreclosure sale. As long as the servicer remedies the violation before the foreclosure sale, then, the borrower should not be able to obtain an injunction. The private right of action states this expressly, providing that servicers that correct any material violation before the property has been sold at a foreclosure sale "shall not be liable." New Civil Code § 2924.12(c). However, servicers may have to litigate the case through summary judgment to defeat the borrower's allegations of a material violation or prove any material violation has been corrected.
- **Enhanced opportunity for strategic behavior.** By creating numerous new technical obligations, the legislation will only expand what we have seen so far in California — borrowers filing suit based on bare-bones allegations of a "material" violation without any obligation to identify in the complaint the nature of the violation or how that violation impacted their access to foreclosure alternatives. We also expect borrowers will attempt to capitalize on the robo-signing provisions to try to breathe new life into the "hold the note" and MERS theories that the California Court of Appeal already rejected. See, e.g., *Gomes v. Countrywide Home Loans, Inc.*, 192 Cal. App. 4th 1149 (2011); *Calvo v. HSBC Bank USA, N.A.*, 199 Cal. App. 4th 118 (2011). Clogged court dockets will greatly delay the resolution of these cases, even for frivolous claims or those that are remedied after the litigation is filed.

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<sup>1</sup> Beacon Economics, LLC, Foreclosure Reform in California: An Economic Analysis (2012).

# Client Alert.

- **Possible defense for signatories of National Mortgage Settlement.** Signatories will not be liable for any violation of these provisions if they are in compliance with the relevant terms of the Settlement. Although “relevant” is not defined, it would seem to refer to the terms of the Consent Order that address the material violation alleged by a particular borrower. Signatories will have to consider how they can meet this compliance standard and may have to move for summary judgment to rely on this defense.
- **Significant state-law conditions on lending activity by federally chartered institutions.** Federally chartered servicers can, and likely will, argue that these new obligations are preempted by federal law. As many federal district courts have recognized with respect to current Civil Code section 2923.5, the right to foreclose in the event of default is an integral function of a bank’s federally authorized lending activities. Servicers will argue Congress did not indicate any intent to authorize state-law conditions on that right, so these new Civil Code provisions are preempted by the National Bank Act. See, e.g., *Parks v. MBNA*, \_\_\_ Cal. 4th \_\_\_, 2012 WL 2345006 (June 21, 2012); *Rose v. Chase Bank USA, N.A.*, 513 F.3d 1032, 1034 (9th Cir. 2008). Servicers also likely will argue that the law is expressly preempted by federal regulations as it creates state-law conditions on the exercise of several specified lending activities, including loan “servicing,” “disclosures,” and “terms of credit,” areas expressly preempted by both OCC and OTS regulations. 12 C.F.R. § 34.4(a)(4), (9), (10); 12 C.F.R. § 560.2(b)(4), (9), (10).

## KEY PROVISIONS

The provisions in the proposed legislation apply only to first liens secured by the borrower’s principal residence. New Civ. Code § 2924.15. Many of the obligations apply only to entities that conduct more than 175 foreclosures a year. We will limit our discussion below to those provisions.

## PURPOSE

The stated purpose of the legislation is to ensure borrowers “are considered for, and have a meaningful opportunity to obtain, available loss mitigation options” offered by the servicer. Section 1; New Civ. Code § 2923.4(a).

The legislation also states expressly that the obligations imposed on servicers do not require a particular result from the servicer’s consideration of a borrower’s eligibility for any foreclosure prevention alternative and nothing in the statute obviates or supersedes the obligations of the signatories to the National Mortgage Settlement. New Civ. Code §§ 2923.4(a), (b).

## DEFINITIONS

- **Mortgage servicer:** any entity that services a loan or is responsible for managing the account and enforcing the note and security instrument.
- **Foreclosure prevention alternative:** a *first lien* loan modification or other available loss mitigation option.
- **Borrower:** a natural person potentially eligible for any federal, state, or proprietary foreclosure prevention alternative program offered by the mortgage servicer; excludes any borrower who has surrendered the property, contracted with an entity whose primary business purpose is to assist strategic defaulters in staying in their homes, or is in bankruptcy. New Civ. Code § 2920.5.

# Client Alert.

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## ADDITIONAL NON-JUDICIAL FORECLOSURE REQUIREMENTS

Adds Civil Code section 2923.55, which augments existing obligations to contact borrower to explore foreclosure alternatives and file declaration of compliance.

- Servicer may not record a notice of default until:
  - 1) 30 days after the servicer has satisfied the requirements of the current section 2923.5 (contacted the borrower to explore foreclosure alternatives or met the requirements for attempting to contact the borrower); and
  - 2) After the servicer has sent a written notice to the borrower stating:
    - The borrower may be entitled to SCRA protections; and
    - The borrower may request a copy of the note, DOT, any assignments required to demonstrate mortgage servicer's right to foreclose, and payment history since the most recent date when the borrower was less than 60 days past due.

Amends Civil Code section 2924, which documents California's non-judicial foreclosure procedure:

- If the foreclosure sale is postponed by at least 10 business days, the mortgagee, beneficiary, or authorized agent must send written notice within 5 business days following the postponement advising the borrower of the postponement and the new sale date and time. New Civ. Code § 2924(a)(5).
- However, failure to do so is not grounds to invalidate a sale that is otherwise valid.
- This provision expires on Jan. 1, 2018, and there is no mirror-image provision to take its place upon expiration.

Adds Civil Code section 2924.9 to codify certain loss mitigation communication requirements from the National Mortgage Settlement:

- Within 5 days of recording a notice of default, the servicer must send a written notice advising the borrower of specified information regarding availability of and method of applying for foreclosure prevention alternatives. Notice need not be sent if the borrower has already been evaluated and there is no change in financial circumstances.
- This section expires on Jan. 1, 2018, and there is no mirror-image provision to take its place upon expiration.

## DUAL TRACKING PROHIBITIONS

Amends current Civil Code section 2923.6 to codify the following requirements from the National Mortgage Settlement:

- Once a borrower submits a complete application for a first lien loan modification, the servicer cannot record any foreclosure documents:
  - 1) until the servicer denies the application and the later of: a) 31 days after written notice of denial, if borrower does not appeal; or b) 15 days after denial of the appeal;
  - 2) unless the borrower does not accept an offered loan modification within 14 days; or
  - 3) unless the borrower accepts the loan modification and defaults on the modified terms.

## Client Alert.

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- A loan modification application is “complete” when the borrower has submitted all required documents “within the reasonable timeframes” set by the servicer.
- Unlike the National Mortgage Settlement, these dual tracking prohibitions are not limited to loan modification applications that are complete no later than day 120 of delinquency.
- This provision expires on Jan. 1, 2018, and there is no mirror-image provision to take its place upon expiration.

Adds Civil Code section 2924.11, which codifies certain dual tracking provisions of the National Mortgage Settlement, including:

- The servicer may not record any foreclosure documents if a foreclosure prevention alternative has been approved in writing and: 1) the borrower is complying with the terms of a written trial or permanent loan modification, forbearance, or repayment plan; or 2) all parties have approved another foreclosure prevention alternative and the servicer has received proof of funds.
- The servicer must rescind a notice of default or notice of trustee’s sale if the borrower is approved for a foreclosure prevention alternative.

### LOAN MODIFICATION EVALUATION OBLIGATIONS

Amends current Civil Code section 2923.6 to codify the following requirements from the National Mortgage Settlement:

- If a loan modification application is denied, the servicer must provide specified information regarding time to appeal the denial and reason(s) for the denial. The servicer is also required to provide a list of steps the borrower must take to be considered for other foreclosure alternatives for which the borrower may be eligible.
- Absent a “material change in the borrower’s financial circumstances,” a servicer is not obligated to evaluate a borrower who already “was evaluated or afforded a fair opportunity to be evaluated” for a loan modification.

Adds Civil Code section 2924.10, which codifies provisions in the National Mortgage Settlement:

- The servicer is required to send written acknowledgment, including specified information, within 5 days of receipt of loan modification application or any document in connection with the application.
- This section expires on Jan. 1, 2018, and there is no mirror-image provision to take its place upon expiration.

Adds Civil Code section 2924.11, which codifies the following provisions of the National Mortgage Settlement:

- A servicer may not charge any fee for considering or implementing any foreclosure prevention alternative and may not charge late fees when: 1) a loan modification application is under consideration or a denial is being appealed; 2) the borrower is making timely modification payments, or 3) another foreclosure prevention alternative is being evaluated or exercised.
- For loans that are sold or service-transferred, the subsequent servicer must honor modified terms approved in writing or other foreclosure prevention alternatives approved by the prior servicer.
- This provision expires on Jan. 1, 2018, and there is no mirror-image provision to take its place upon expiration.

# Client Alert.

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## SINGLE POINT OF CONTACT

Adds Civil Code section 2923.7, which codifies the single point of contact provisions in the National Mortgage Settlement requiring servicers to establish an individual or team of personnel who are knowledgeable about the borrower's situation and can perform the following:

- Communicate process and deadlines for applying for foreclosure prevention alternatives;
- Coordinate receipt of documents and notify the borrower of any missing documents;
- Have access to current information sufficient to timely, accurately, and adequately inform the borrower of current status of foreclosure prevention alternatives;
- Ensure the borrower is considered for all offered foreclosure prevention alternatives;
- Notify individuals with the ability and authority to stop foreclosure proceedings; and
- Transfer a borrower to a supervisor upon request.

## ROBOSIGNING PREVENTION AND CIVIL PENALTIES

Amends Civil Code section 2924, which documents California's non-judicial foreclosure procedures, to codify existing law by:

- Requiring the entity that files the notice of default to be the holder of the beneficial interest, the original or substituted trustee, or the designated agent of the holder. The latter must be acting within the scope of authority designated by the holder.

Adds Civil Code section 2924.17, which codifies provisions of the National Mortgage Settlement:

- Section 2923.55 declarations and all other recorded non-judicial foreclosure documents must be "accurate and complete and supported by competent and reliable evidence."
- The servicer must ensure it has reviewed "competent and reliable evidence" to substantiate the borrower's default and the right to foreclose before recording any foreclosure documents.
- Goes beyond the National Mortgage Settlement in establishing a civil penalty of up to \$7,500 per loan for servicers who engage in "multiple and repeated uncorrected violations" of these provisions in actions brought by the State Attorney General, a district attorney, or specified state regulators. This penalty provision expires on Jan. 1, 2018, although the underlying obligations will remain in effect.

## PRIVATE RIGHT OF ACTION

Adds Civil Code section 2924.12, which codifies the existing private right of action for violation of the non-judicial foreclosure laws, but creates new remedies and a possible right to recover attorney's fees:

- Borrowers may pursue a claim for any "material" violation of any of the provisions discussed above other than section 2924.
- Prior to the recording of the trustee's deed upon sale, borrowers may seek an injunction of the foreclosure sale. Any injunction will remain in place until the court grants the servicer's motion to dissolve it based on a showing that the servicer has remedied the violation.

## Client Alert.

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- After the trustee's deed upon sale has been recorded, borrowers can seek "actual economic damages" caused by a material violation that was not corrected before the sale. Borrowers can recover the greater of \$50,000 or treble actual damages if the court finds the material violation was "intentional or reckless, or resulted from willful misconduct."
- A mortgage servicer, mortgagee, trustee, beneficiary, or authorized agent "shall not be liable for any violation" that is corrected or remedied prior to the recording of the trustee's deed upon sale.
- This provision exempts signatories to the National Mortgage Settlement from liability if they are in compliance with the "relevant terms" of the Settlement with respect to the borrower who brought suit.
- The court *may* award attorney's fees and costs to a "prevailing borrower," defined as a borrower who obtained injunctive relief or was awarded damages.

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