The Future of Foreclosure

Roger Bernhardt

Introduction

There is considerable overlap in the foreclosure decisions that appear in this and the previous issue of the Reporter. The holding in *Pfeifer v Countrywide* (2012) 211 CA4th 1250 (reported in the March issue on p 44) that lenders were required to conduct face-to-face meetings with their borrowers as a precondition to foreclosing their deeds of trust was echoed in *Intengan v BAC Home Loans Servicing LP* (2013) 214 CA4th 1047 (reported on p 66 of this issue), with the latter decision based on the authority under CC §2923.5 rather than under HUD servicing regulations. Either way, another layer of complexity and time (and risk) has been added onto California's nonjudicial trustee sale process.

Similarly, the question of Chase Bank's immunity from liability for the torts of Washington Mutual (WAMU) because of the terms of its Purchase and Assumption Agreement with the FDIC, examined in *Jolley v Chase Home Fin., LLC* (2013) 213 CA4th 872 (reported on p 46 of the March issue), was again taken up in *Scott v JPMorgan Chase Bank* (2013) 214 CA4th 743 (reported on p 66 of this issue), although with quite different results (to be discussed below).

Only *West v Chase Bank*'s coverage of the question of whether a lender is obliged to offer a loan modification to a borrower who has survived the trial period plan mandated by HAMP could be called original—although, as the opinion itself acknowledges, the issue is far from being a novel one, with a significant Seventh Circuit decision already available for courts to rely on. *West v JPMorgan Chase Bank* (2013) 214 CA4th 780, reported on p 67 of this issue.

Jolley and *Scott*

Of all of these decisions, *Jolley* no doubt is attracting the most attention and is sure to be cited in countless briefs and motions by borrowers. The distinction offered by the *Scott* court—that judicial notice could be taken of the immunizing FDIC agreement because its authenticity and completeness were not in dispute, as they were in *Jolley*—will only inspire borrowers' trial counsel to work all the harder to make their challenge to that document as early and as thorough as possible. Every case contending that WAMU had done some wrong will now include a person formerly connected with that institution who will declare or testify to some problem with its FDIC transfer to Chase.

More significantly, the *Scott* opinion did not really dispose of the other half of the *Jolley* opinion—the part that held that Chase may have been guilty of breaching its own independent duty of care to its borrower even if the FDIC agreement gave it immunity from WAMU's wrongful acts.

> We conclude here, where there was an ongoing dispute about WaMu's performance of the construction loan contract, where that dispute appears to have bridged the FDIC's receivership and Chase's acquisition of the construction loan, and where specific representations were made by a Chase representative as to the likelihood of a loan modification, a cause of action for negligence has been stated that cannot be properly resolved based on lack of duty alone.

Jolley, 213 CA4th at 898. The foregoing statement is too ambiguous to be always read as safely limited to situations when a successor lender, separated by an FDIC intervention, is being sued for its own acts and those of its predecessor that straddled the loan turnover. It can too easily also be read without those historical qualifiers to resurrect the doctrines of lender liability for what is regarded as misbehavior that occurred during lengthy loan modification negotiations, allowing borrowers not only to enjoin or set aside foreclosure sales, but also to recover damages for workout arrangements that fell through. Chase Bank may not only have lost its own defense of immunity behind its FDIC agreement, but may have exposed itself (and other banks) to independent liability for not adequately reviewing the history of previous modification negotiations of a problem loan—whether handled by a predecessor lender or simply by former members of its own staff at earlier workout sessions.

The *Jolley* court also sought to distinguish its own holding by stressing that a construction loan rather than an acquisition loan was involved, thus affording it an opportunity to assert that a lender's obligations in those former situations are more enduring than in the latter, because the funding process in construction situations lasts so much longer. But I am equally unsure of the permanence of that distinction, because a court could cogently hold that a borrower who has run into problems with her existing loan and is engaged in a lengthy process of discussing a restructuring arrangement with her lender is involved in the same kind of ongoing relationship that characterized *Jolley*, thus justifying a consideration of the same kind of lender duties of care.

In light of all of these uncertainties, *Jolley* is the decision most likely to be mentioned in other opinions, whether with respect or with dismissal.

A Common Problem

I was struck by one feature that pervaded all of these cases:

- In *Intengan v BAC Home Loans Servicing LP*, the Notice of Default was sent in December 2010—2 years before the appellate opinion was issued.
- In *Scott v JPMorgan Chase Bank*, the Notice of Default was sent in January 2009—over 3 years before that decision.
- In *West v Chase Bank*, a Notice of Default was sent in March 2009, but then the debtor went on a Trial Period Plan that lasted until the bank rejected her payment in May 2010—so 3–4 years earlier.

The time periods of the cases reported in the last issue of the Reporter were similar:

- In *Jolley v Chase*, I did not see a Notice of Default date, but the opinion said that the debtor had stopped making payments in November 2008—5 years before.
- In *Pfeifer v Countrywide*, the NOD was filed May 2009—4 years earlier.

As of May 2013, the trustors' defaults appear to have continued for 3–7 years—probably even longer, if one factors in that Notices of Default were probably not filed until several months after the first missed payment. It is reasonable to further assume that these debtors have not resumed making the installment payments that their loan agreements called for while they remain in possession of their properties. Evidently, trustee sales are no longer the mechanism for speedy relief that they were originally intended to be.

Debtors' Needs for More Time

Giving mortgagors extra time has always been a popular form of debtor relief. Indeed, the original equity of redemption that started mortgage law allowed mortgagors to "redeem" themselves from the legal effect of having not paid their debts on "law day" by allowing them to avoid a forfeiture by paying late, *i.e.*, after the debt was legally due. In the 1930s, when even the equity of redemption and the replacement of strict foreclosure with foreclosure by sale did not help enough, legislatures enacted foreclosure moratoriums, postponing completion even further. Moratoriums were later replaced with antideficiency laws as a more expansive form of debtor protection. However, these antideficiency laws no longer seem to play as significant a role in residential financing, given the lending industry's preference for nonjudicial trustee sales despite their effect of triggering CCP §580d antideficiency protection and its conversion of homeowner nonpurchase-money loans into nonrecourse debt.

I hear rumors that lenders are beginning to consider judicial foreclosures again, driven to that position by the new impediments they perceive as being thrown in their way by the California Homeowners Bill of Rights statutes and the regulations of the federal Consumer Financial Protection Board. Lenders have always been as interested in circumventing the debtor protection rules as the courts and legislature have been in imposing them on the lenders.

The original virtue of the trustee sale was that it was a nonjudicial procedure. Lenders who complied could bypass the court system and its delays (and the need for attorney appearances) and complete foreclosures in less than 6 months. The fall of the auctioneer's hammer would give only title relief and would not get the borrower out of possession, but the fact that trustee sales are included along with leases within our unlawful detainer statute made that second step less dilatory and costly when it also had to be taken.

Today, however, it seems to me that the great vice of the trustee sale is that it is nonjudicial—it makes no judicial official available to oversee the process. The initial worry about nonjudicial foreclosures was that debtors would be denied their opportunity to assert defenses; now, the worry is that lenders have no opportunity to correct their mistakes while the process is being conducted.

Indeed, "correct their mistakes" is an understatement, since nonjudicial sales include no arrangement for getting any guidance as to whether what is being or not being done, or proposed to be done or not done, is or is not a mistake. When a trustee sale has been started but the debtor contends that it should not continue because of what she perceives as some error, there is no one to decide the issue. The trustee, of course, has the technical power to decide (by proceeding with the sale), but if the debtor then files a lawsuit challenging that determination, a final judicial decision on the merits may not be rendered for another several years, often long after the sale was completed but with the effect of completely undoing it and making the lender start all over. These decisions starkly demonstrate the increase of that phenomenon.

The previous idea had been that all answers could be legislatively prescribed in advance, so that lenders would always know exactly what to do, but this clearly has not worked. Our code sections on foreclosure already count some 60,000 words (the new Homeowners Bill of Rights adds even more this year and the Consumer Finance Protection Bureau regulations take up thousands of pages). No one should believe that those will give lenders the answers they need or the tools necessary to do everything right. New statutes and regulations containing more and more details announced in advance are no substitute for decisions that need to be made once the controversy has turned actual.

A Case for Going Back to Courthouses

In 1381, England took away the rights of landlords to use nonjudicial self-help to evict their defaulting tenants, replacing that power with what in California is now our statutory unlawful detainer process, which works through the court system rather than outside it. When unlawful detainer is compared to the perils besetting the current nonjudicial trustee sales mechanism and the aftermath of judicial review of them, a *judicial* foreclosure scheme modeled on how tenant evictions are treated might work out better for both sides.

For debtors, judicial foreclosure would give them the opportunity to have their defenses heard before their property is taken away by foreclosure: They could assert all of their claims about bad loan origination (*e.g.,* the predatory terms, the fraudulent promises, the misdescribed documents), bad subsequent loan processing (*e.g.,* the false assurances of delay, the contradictory responses, the frustrating runarounds), or the many in-between issues (*e.g.,* "show me the note" or "where is your tender"), which contentions could be disposed of as early in the fight as possible and with as much finality as a summary judgment-type procedure could offer.

For lenders, a judicial foreclosure procedure could effectively eliminate the risks and consequences that a challenged conduct will later be determined to have amounted to a fatal error. For instance, if a face-to-face meeting should have been offered but was not effectively furnished, that mistake can be corrected promptly, rather than hovering overhead for 3–4 years with the effect of only then invalidating a long-completed sale. Of course, appeals can always be taken and trial courts can always be reversed, but hazards are still reduced for both sides when sustained demurrers and granted summary judgments educate parties at the outset on the weaknesses of their positions.

A specialized judicial foreclosure proceeding could also deal with the practical problem of the debtor's payment-free possession for the life of the litigation by copying what is often done in implied warranty of habitability disputes in residential leasing: through pendente lite orders requiring mortgagors to make interim payments as a condition of postponing the plenary resolution of their disputes. (Overall effectiveness could be enlarged even further by folding in an unlawful detainer remedy as part of the final relief granted to those mortgagees who prevailed on all issues.)

The ideal way for all this to come about would be by legislation: a new residential foreclosure act that includes the creation of special housing courts, fast-track procedures (perhaps doubly fast when deficiency claims are waived), and more sensible and inclusive relief at the end (including negotiated receivership sales rather than auctions and the possibility of leaseback arrangements with debtors). That utopia is not likely to happen, but even without such improvements, lenders' attorneys should start thinking about advising their clients that while old-fashioned, unreformed judicial foreclosures may be slower, they may nevertheless be a safer, and ultimately cheaper, course to follow.

National reform movements have always gone in the opposite direction: attempting to improve the nonjudicial foreclosure procedure in ways to eliminate its deficiencies (*e.g.,* the Uniform Land Transactions Act, the Uniform Land Security Interests Act, the Uniform Nonjudicial Foreclosure Act, and now the (draft) Residential Real Estate Mortgage Foreclosure and Protections Act). But those approaches all concede a premise that may no longer be tenable—that the foreclosure process can be safely or efficiently run without contemporaneous judicial supervision. After-the-fact oversight is too time-consuming and too late.