New Developments in the Mortgage Foreclosure Crisis

By: *Patrick M. Roberts, Esq.* Published: *National Mortgage Professional*

April 2012

The real estate market's foreclosure crisis continues to evolve and, as it does, so does the law governing wrongful foreclosure and related lender defenses.

One theory that homeowners have used to set aside foreclosures in the past, was that an improper assignment or transfer of the mortgage or Deed of Trust by the lenders rendered it invalid. Historically, whenever a mortgage or Deed of Trust was transferred or assigned, the transaction was recorded in the real property records. However, in recent years, lenders have transferred Deeds of Trust or mortgages (or certain fractional shares of the same) so frequently that lenders no longer record each particular assignment. To assist with the epidemic of mortgage recordation, lenders began utilizing the Mortgage Electronic Registration Systems ("MERS") – a nationwide registry system which held various Deeds of Trust in its name. When an interest was transferred, the Deed of Trust stayed in the name of MERS, and a transfer was simply made in the internal records.

An argument raised by homeowners in foreclosure litigation following the adoption of MERS was that MERS itself was illegal, and foreclosures under Deeds of Trust held by MERS were improper and could be set aside. Specifically, borrowers would allege that MERS was not the "true" beneficiary under the Deed of Trust, never had ownership of the promissory note, nor held an assignable interest in the note or Deed of Trust. As such, any assignment of the note by MERS to any other institution was invalid.

The law is clear that any irregularity in a foreclosure is construed against the homeowner, who has the burden of proof when contending that a particular foreclosure sale is invalid because a lender lacked authority to conduct it. Lenders previously argued that showing MERS to be merely a nominee was insufficient to demonstrate that it lacked authority to make a valid assignment on a note on behalf of the original lender. Prior to 2012, there was very little California authority on this particular issue. However, three recent California Court of Appeal

decisions have affirmatively rejected attacks on MERS in favor of lenders: *Ferguson v. Avelo Mortgage, LLC*, *Gomes v. Countrywide Home Loans*, and *Fontenot v. Wells Fargo*. These decisions can be cited for the proposition that California homeowners are unlikely to prevail on the arguments that MERS is not valid or that the foreclosing lender has to prove the validity of its assignment.

As the cases demonstrate, a lender's typical defense to a wrongful foreclosure lawsuit is to argue that, under the prevailing law (specifically <u>Civil Code</u> Section 2924), a homeowner must show that there was an irregularity in the trustee sale – an often insurmountable burden for plaintiff homeowners, as the sale is presumed to be valid pursuant to statute, but this is not a closed issue.

Just last December, the California Court of Appeal in *Lona v. Citibank, N.A.* determined that when a bank fails to consider the income and credit of a homeowner before issuing a loan, that loan agreement may be unconscionable. In *Lona*, a lender enticed a homeowner to refinance his home for $1,500,000, saddling the homeowner with monthly payments four times greater than his income. After he defaulted on payments and the house was sold at a foreclosure sale, the homeowner filed an action for "predatory lending" (i.e., lending sums of money which cannot possibly be repaid by a borrower based on their income) against the lender, the loan servicer and others, seeking to set aside the sale. Despite the homeowner's failure to tender amounts due on his loan – usually a requirement to set aside the sale – and even though no statutory exceptions to this "tender requirement" applied, the court ultimately decided that, pursuant to <u>Civil Code</u> Section 1670.5, the homeowner would be allowed to proceed to trial on the issue of unconscionability based on the argument that the loan was both unconscionable and illegal because they were made to the homeowner without reasonable consideration of his ability to repay the loan given his income at the time, and further, the interest rate far exceeded what was reasonable given his credit rating at the time of the application.

Lona raises an interesting issue for homeowners, who, instead of claiming one of the four historical exceptions to the tender requirement, may now be able to argue unconscionability to circumvent their obligation to tender amounts due to their lender in order to set aside a foreclosure sale. The court made note of the four historical exceptions to the tender requirement, stating that a tender will not be required if the borrower's action attacks the validity of the underlying debt; when the person seeking to set aside the sale has a counterclaim or set off against the beneficiary; where it would be inequitable to impose such a condition on the party challenging the sale; and when the trustor is not required to rely on equity to attack the deed because the trustee's deed is void on its face.

The specific holding of *Lona* was that the lenders failed to timely oppose the homeowner's argument that the tender requirement did not apply due to his objection to the validity of the debt, based on unconscionability. While the case is limited in its application and is by no means resolved, this is an interesting issue which will bear observation in the future to determine if other courts refine the unconscionability argument relating to predatory lending. If so, borrowers may have another weapon in the arsenal for opposing lender foreclosure actions.

Patrick M. Roberts is an experienced litigator and trial lawyer in matters including business disputes and construction related claims and defects. He can be reached at proberts@grayduffylaw.com or 818-907-4000.