CALIFORNIA'S HOMEOWNER BILL OF RIGHTS

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CALIFORNIA GOVERNOR JERRY BROWN on July 11, 2012, signed the laws constituting his state's Homeowner Bill of Rights. With its passage, California lawmakers completed their second act of mortgage reform, following the $18 billion secured for California in the February 2012 National Mortgage Servicing Settlement.

Beginning Jan. 1, 2013, new requirements apply to lenders processing more than 175 residential foreclosures annually. The law applies to owner-occupied first-lien one-to-four-family residential mortgages.

Many of the new legal requirements focus on servicer obligations in the context of foreclosure-prevention alternatives. Servicers can no longer conduct "dual-track foreclosures," essentially ending the practice of processing a foreclosure while a loan-modification application is pending. Servicers are also subject to new requirements before and after filing notice of default, including making mandatory disclosures and identifying a single point of contact (SPOC), and must comply with measures designed to end the filing of unverified documents.

However, the greatest concern for the mortgage servicing industry is the potential for penalties for noncompliance, including the creation of a cause of action for any material violation.

The borrower's right to sue for claimed material violations threatens to open a floodgate of litigation. Moreover, the law's failure to define the term "material violation" promises legal battles over what degree of noncompliance warrants the new civil penalties.

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New borrower cause of action

The Homeowner Bill of Rights creates a private right of action for borrowers, but leaves many open questions about the responsibilities of servicers. These uncertainties challenge mortgage companies to determine how best to avoid lawsuits—and how to avoid liability once suits are filed.

The law gives borrowers the right to relief for material violations of specified provisions, including sections 2923.55 (prerequisites to recording a notice of default), 2923.6 (ban on dual-track foreclosures), 2923.7 (the single point of contact), 2924.9 (disclosures associated with recording a notice of default), 2924.10 (receipt and denial of modification applications), 2924.11 (ban on dual-track foreclosures) and 2924.17 (robo-signing ban).

Before recordation of the trustee's deed upon sale, the borrower can sue for injunctive relief. After recordation, a lawsuit may be filed for actual economic damages, including treble damages in certain circumstances. While private right of actions with limited remedies are available under certain provisions in California's mortgage laws, the broad authorization of private lawsuits in the Homeowner Bill of Rights is new.

What is a material violation? The term is undefined, and leaves to courts the duty to draw the line between liability and harmless foul. Lawmakers seemingly envisioned "a narrow and targeted enforcement mechanism" in which the term "material violations" limits potential claims. The California Assembly noted that the provisions "protect against any potential frivolous claims or efforts to merely delay legitimate foreclosure proceedings" by ensuring that "no legal action could be brought unless the violation is material."

Further complicating matters is the prospect of additional damages for "intentional or reckless" violations or for "willful misconduct," in the amount of the greater of treble damages or $50,000. A one-sided attorneys' fees and costs provision allows prevailing borrowers, but not mortgage companies, to recover reasonable fees and costs—a provision likely to promote plaintiffs' litigation.

It is unclear whether borrower class actions are authorized. The text neither explicitly authorizes nor denies them. Many of the Homeowner Bill of Rights requirements do not seem amenable to certification. For instance, some allegations will require an individualized inquiry into whether a modification application is "complete."

Mortgage servicers have a partial safe harbor—they can remedy material violations before the trustee's sale deed is recorded. Having done so, they can move to dissolve an injunction by showing that the material violation has been corrected. Similar safe harbors are found in California's construction defect and employment litigation statutes. There is no similar safe harbor, however, after the trustee's sale deed has been recorded.

In addition to the safe harbor, other affirmative defenses are available. Some can be easily invoked, where the borrower is in bankruptcy or has already surrendered the property. Servicers in compliance with the National Mortgage Servicing Settlement are immune from liability. Another exception bars claims by borrowers "who [have] contracted with an organization . . . whose primary business is advising people . . . on how to extend the foreclosure process. . . ." The coverage of this language is uncertain enough that servicers should be cautious about relying on the exception.

Servicers must document every contact with borrowers seeking foreclosure alternatives, and associate these contacts with detailed notes about every foreclosure alternative offered.

The newly created borrower cause of action, combined with the potential for attorneys' fees and costs, may lead to a surge in lawsuits for seemingly trivial servicing violations as plaintiffs' attorneys test the scope of the law and borrowers seek to avoid foreclosure through new legal means. To avoid becoming ensnared in such suits, lenders should carefully study the many new requirements of the Homeowner Bill of Rights.

Prerequisites to recording a notice of default

Before recording a notice of default, a servicer, lender, trustee, beneficiary or authorized agent must:

- *Offer to provide documentation.* The servicer must send the borrower a notice advising that if he or she is a service member or dependent, the borrower may be entitled to additional protections, and a written statement that the borrower may request a copy of the promissory note, deed of trust, any assignment of the mortgage and the payment history since the last time the loan was less than 60 days past due.
- *Explore foreclosure avoidance.* At least 30 days before recording a notice of default, the servicer must have made initial contact with the borrower to assess his or her financial situation and explore foreclosure-avoidance options.
- *Refrain from dual-track foreclosures.* If the borrower has completed an application for a loan modification, the servicer cannot record a notice of default or sale, or conduct a trustee's sale while the application is pending. A notice of default may not be recorded if the modification or another foreclosure-prevention alternative has been approved in writing and either the borrower is in compliance with the terms of the plan or the plan is approved of by all parties.

Currently, a lender need only attempt to contact the borrower by telephone on three occasions and then send a letter in order to file a notice of default.

The dual-track foreclosure ban is problematic because it lacks a "bright line" rule or useable definition of what constitutes a complete loan-modification application. To minimize disputes, servicers should implement clear and precise policies for their modification programs, including definitive lists of the documents required to complete a modification application.

Robust mechanisms must be implemented to halt foreclosure processing once the required documents are received. Obviously, the concept of "receipt" is potentially ambiguous when applied to a servicer receiving thousands of documents per day, via U.S. mail, email and fax. Disputes over receipt may constitute another potential hazard for lenders defending lawsuits alleging noncompliance.

New procedures for foreclosure-prevention alternatives

Servicers must acknowledge in writing, within five days, receipt of complete modification applications and associated documents. This acknowledgment must describe the modification process and notify the borrower of any deficiencies in his or her application.

As with the dual-track foreclosure ban, the definition of a complete application is ambiguous. The law does not define "document" or even "application." Prudence suggests that servicers must take an expansive view of what documents trigger written acknowledgements, at the risk of borrower lawsuits claiming compliance violations.

Once a borrower accepts a loan modification or foreclosure-prevention alternative, the servicer must provide a copy of the fully executed agreement and can no longer charge an application fee, processing fee or other fee, or any late fee for failure to timely make loan payments while the modification application is being considered or appealed. Denied applications must state reasons for denial and the deadline for appeal.

Single point of contact

The Homeowner Bill of Rights creates a cause of action against servicers who fail to establish a single point of contact when a borrower requests a foreclosure-prevention alternative. The contact may be an individual or a team of personnel, so long as each team member has the ability and authority to perform the required responsibilities. The single point of contact must remain assigned to the borrower until all loss-mitigation options have been exhausted or the loan is brought current.

Currently, the lender or authorized agent is required to maintain a toll-free telephone number allowing borrowers to contact a live representative, as well as accessible information on its website.

How courts will interpret a material violation of the single point of contact requirement may be one of the most unpredictable elements of the Homeowner Bill of Rights. What acts will be held to constitute failure to communicate the process by which a borrower may apply for foreclosure prevention? How can servicers prove that a borrower was considered for all loss-mitigation options offered?

What is clear, despite these ambiguities, is that servicers must document every contact with borrowers seeking foreclosure alternatives, and associate these contacts with detailed notes about every foreclosure alternative offered. In an environment where foreclosure alternatives are proliferating, the risk of inadequate recordkeeping is rising. As worrisome is the potential for servicers to limit their foreclosure alternatives in an effort to avoid the potential liability for noncompliance.

New post-default requirements

Within five business days of recording a notice of default, a servicer offering one or more foreclosure-prevention alternatives must notify the borrower in writing that the borrower may be evaluated for one or more foreclosure-prevention alternatives, whether an application is required to be considered for those alternatives, and how the application may be obtained. The dual-track foreclosure ban, discussed earlier, mandates that the notice of default be rescinded and a pending sale be canceled when a permanent foreclosure-prevention alternative has been executed.

In an effort to eradicate robo-signing, certain documents can no longer be filed or recorded without the servicer first reviewing competent and reliable evidence of the borrower's default and the right to foreclose. These documents include any declaration, notice of default, notice of sale, assignment of a deed of trust, or substitution of trustee recorded in a foreclosure, and any declaration filed in court relating to foreclosure. In addition to the borrower's right to a cause of action for material violations of this requirement, the Homeowner Bill of Rights allows civil prosecutors to seek civil penalties of up to $7,500 per loan for repeated recording and filing of multiple unverified documents.

The impact

With the Homeowner Bill of Rights, California raised the bar for foreclosure reform. Servicers should expect increased individual lawsuits by borrowers hoping to stall or defeat foreclosure, and claims for compensation relating to completed foreclosures and failed loss-mitigation efforts. Already burdened courts will be asked to define essential terms in the Homeowner Bill of Rights, with the potential for inconsistent outcomes for similarly situated borrowers and servicers. It is impossible to know if borrowers will benefit in meaningful ways from their new "rights," but it seems certain that California courts, lawyers and mortgage industry compliance officers will face 2013 with more mortgage-related concerns than ever.

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