DS news

INDUSTRY INSIGHT / T. ROBERT FINLAY, ESQ.

A Court of Appeal has limited the lender's right to recover attorney's fees after successfully defending against the borrower's lawsuit challenging a foreclosure. That could mean a victory in court could still prove costly.

Recovering attorney's fees can be a contentious aspect of any legal proceeding. When it involves navigating the terrain of foreclosures, the process can become even more complicated. A pair of recent decisions from the California Court of Appeals have provided clarification when it comes to whether and how servicers can recover their attorney's fees after successfully defending challenges to their deed of trust (DOT)—and unfortunately, the news is potentially troubling.

In both *Hart v. Clear Recon Corp* and *Nationstar and Chacker v. JPMorgan Chase Bank,* separate panels of the Second Appellate District held that the provisions in the standard form deed of trust relied on by the prevailing lender only allowed the holder to add fees and costs incurred in defending the litigation to the loan balance. The provisions did not, however, allow for a separately recoverable fee award against the borrower. In other words, if the property does not have sufficient equity to cover these amounts, the holder is out of luck. And, even worse, if the defendant assigned away its interest in the DOT before judgment, it is completely out of luck as it would not even have the potential for recovering its fees through the foreclosure sale. As the Court, quoting the late Justice Scalia in another context, stated in *Chacker*, the assignor "must take the bitter with the sweet."

THE BITTER AND THE SWEET

The facts and ruling of both cases are relatively similar. In *Chacker*, the borrower sued Chase to stop the foreclosure sale. Chase's demurrer was sustained without leave to amend, and the trial court entered a judgment of dismissal. Chase's attorneys then moved for attorney's fees under the standard language of paragraphs 9 and 14 of the DOT, which was granted by the trial court. The Court of Appeal reversed, vacating the judgment for fees and ordering that Chase's attorney's fees could only be added to the loan balance, not collected directly from the borrower.

THE ROCKY ROAD TO
FEE RECOVERY

As the court, quoting the late Justice Scalia in another context, stated, the assignor "must take the bitter with the sweet."

The published portion of the appeal did not focus on Chase's right to recover fees or the amount of the fees. Instead, the decision focused on whether paragraphs 9 and 14 of the DOT limit Chase to adding the fees to the amount owed under the DOT, or whether these provisions supported a separate judgment against the borrower, independent of its repayment obligations under the note and the DOT. Paragraph 9 of the relevant DOT provided that the lender may pay reasonable attorney's fees to protect its interest in the property or DOT. However, the plain language of the DOT specifies that "any amounts disbursed by Lender under this Section 9 shall become additional debt of the Borrower secured by this [DOT]." The Court held that the plain language of paragraph 9 did not provide for a separate award of attorney's fees. Likewise, paragraph 14 of the DOT states that the lender may "charge" the borrower fees for services performed in connection with borrower's default, for the purpose of protecting lender's interest in the property or DOT, including attorney's fees. However, again, the plain language of this paragraph provides that the attorney's fees are to be added or "charged" to the loan balance. As a result, paragraph 14 did not permit a freestanding contractual attorney fee award. Paragraphs 9 and 14 of Chase's DOT reflect the standard language used by most institutional, residential lenders.

Adding insult to injury, and leading to its quote from Justice Scalia, the Court rejected Chase's point that the adding of the fees to the loan balance did nothing to assist Chase in recovering the fees it had incurred because it no longer had any interest in the loan, as the rights had been assigned to another financial institution and therefore would not be paid out of any subsequent foreclosure. The court observed that Chase could have protected itself against that result by including language in the assignment "to account for how attorney fees may be recovered when a borrower defaults."

In *Hart,* two plaintiffs (mother and son) sued Nationstar for wrongful foreclosure. Neither plaintiff was the borrower under the DOT, and the sole borrower was not a party to the action. Nationstar obtained summary judgment on the basis that the plaintiffs were not borrowers, and therefore had no rights under the DOT, and had no right to sue to stop the foreclosure. Nationstar's attorneys sought its attorney's fees as a prevailing party under the DOT. Unlike in *Chacker,* Nationstar relied exclusively on the attorney fee language in paragraph 9 of the DOT. Like Chase's DOT, paragraph 9 of Nationstar's DOT provided that, if there is a legal proceeding that might significantly affect the lender's interest in the property or security, the lender may do and pay for whatever is reasonable to protect the lender's interest, including paying attorney's fees to defend itself in a lawsuit. The provision then provides that "[a]ny amounts disbursed by Lender under this Section 9 shall become additional debt of Borrower secured by this Security Instrument." Trial Court granted Nationstar's attorney's fees motion, holding that paragraph 9 of the DOT was an attorney's fees provision. The Court of Appeals reversed, however, holding that paragraph 9 did not permit an award of attorneys' fees against the plaintiffs.

On appeal, Nationstar argued that it was entitled to a fee award under paragraphs 9, 14, and 22 of the DOT, as well as the note. The Court of Appeals refused to consider on appeal whether paragraphs 14 or 22 of the DOT, or the note itself, justified an award because Nationstar had failed to raise these arguments at the trial court level. Instead, the Court focused exclusively on what was before it—paragraph 9. Like in *Chacker,* the Court concluded that the plain language of paragraph 9 does not provide for an award of attorney's fees. Rather, it is "a provision that attorney's fees, like any other expenses the lender may incur to protect its interest, will be added to the secured debt." The Court did, however, note that the result may have been different had Nationstar moved originally under paragraph 22. Likewise, and as discussed more below, we believe the result could be different if the lender had moved for fees under the language in the note.

SPEEDBUMPS ALONG THE WAY

What do these decisions mean for a lender or servicer who successfully defends a challenge to the foreclosure or DOT brought by the borrower or a related party? While the *Hart* and *Chacker* decisions are disheartening on their face, there are options for getting around their holdings. In addition, the decisions raise several interesting issues for a lender or loan servicer to consider, including:

Review your DOT: While most institutional lenders use DOTs with similar language to the ones at issue in these two cases, the language in conventional, private party, and some older DOTs vary. At the onset of your case, we suggest looking at your specific DOT to determine

whether it has language that varies from the language in the Chase and Nationstar DOTs.

Move for fees under paragraph 22 of the note: Although rejected as not timely raised, Nationstar raised an excellent argument on appeal, i.e., that the language in the acceleration paragraph 22 provided for attorney's fees but did not restrict the recovery of those fees to adding the fees to the amounts owed under the note and DOT. Likewise, many notes contain language providing for attorney's fees to the prevailing lender. If the note involved in your litigation contains favorable attorney fee language, use that as the basis or your fee motion.

Post-foreclosure fees: While not directly addressed in either of the Court's rulings, without another ground for a fee judgment, lenders are presumably barred from recovering fees post-foreclosure. If the lender's only recourse is to add the fees to the amount owed under the note and DOT and the foreclosure sale has already occurred, there is no loan to add the fees to!

Recovering fees post-transfer: As Chase found out the hard way, while you may be entitled to add fees to the note and DOT, that process is complicated if the loan has been sold or service transferred prior to resolving the litigation. Logistically, how can the prior lender add fees to a note they no longer own or service and, even if they could, how would one collect them? It can be done but it will require lots of calls to the new lender or servicer.

Can a servicer recover fees under the DOT? California law is mixed on whether a servicer can recover fees under the DOT. Fortunately, most decisions and courts side with the servicer. While the *Hart* and *Chacker* decisions focused on the successor to the lender's right to recover fees, the rulings will apply similarly to a servicer. Indeed, implicit under *Chacker* was its acceptance that Chase, even as a non-party, was entitled, as an agent of the owner, to be paid its fees—it just was limited to doing so by adding them to the loan balance. Likewise, the servicer will have the same challenges collecting fees if the servicing of the loan has already transferred to a new servicer.

Can the foreclosure trustee recover its litigation defense fees? Whether a foreclosing trustee named in borrower litigation can recover its litigation defenses fees and costs is a complicated question. Regardless of the recent decisions discussed above, most standard form DOTs do not contain language specifically allowing the trustee to obtain a fee award or add them directly to the loan. It will generally require nonstandard language specifically providing that the trustee can recover fees. (Note: the Court did confirm fees for the trustee in the *Chacker* case; however, it appears to have done so without much thought and perhaps was an oversight.)

Can the borrower still recover fees? Unfortunately, yes. While it might seem inequitable, the reciprocal language of Civil Code section 1717 still gives the prevailing borrower the ability to recover a fee award, even if the prevailing lender or servicer is limited to adding the fees to the loan.

Do you need to move for fees or can you add them directly to your DOT? Even before these decisions, servicers and lenders often asked our firm if they could simply add the attorney's fees and costs directly to the loan like they do with advances for taxes, inspection fees, bankruptcy fees, non-judicial foreclosure fees, etc. The answer was almost uniformly—no. Although the DOT language cited above appears to provide that the attorney's fees in defensive litigation with the borrower can be added directly to the loan, Civil Code section 1717 provides that only the prevailing party is entitled to fees (and the fees must be reasonable). Therefore, until the lender wins and is awarded "reasonable" fees, the lender cannot simply add them directly to the loan. However, the *Hart* and *Chacker* decisions appear to bring into question the traditional approach. Both decisions repeatedly point to the language in the DOT that the fees can be added directly to the loan. In fact, the Court in *Hart* vacated the fee award completely, holding that Nationstar was essentially free to apply the fees directly to the loan. "[Paragraph 9] is, instead, a provision that attorney's fees, like any other expenses the lender may incur to protect its interest, will be added to the secured debt."

However, there are other issues at play, and we strongly recommend consulting with our office or another attorney before adding any litigation-related fees directly to your DOT.

Updating the attorney fee language in your DOT: While it might be difficult for institutional lenders, private and conventional lenders can revise the language in their DOTs to clearly state that the lender is entitled to add the fees to the loan or, at its sole discretion, obtain an attorney fee award. Again, please consult your attorney before revising the provisions in your DOT.

Why do I even care if the borrower is already in default? In most instances where the borrower sues its lender, the loan is in default. If the borrower cannot afford to make his or her mortgage payments, he or she often cannot reimburse a lender for its litigation fees and costs. For the last decade or so, it did not make much sense for a lender to incur the expense of moving for fees. Now, however, with property values in California at or above all-time peaks, many litigious borrowers have equity in their homes. If they chose to sue and are unsuccessful, the prevailing lender may want to consider trying to recover its defense costs from the equity in the property. In addition, with borrowers who are serial litigants, the threat of having to pay fees when they lose might help dissuade them.

As you can see, while the Court's recent decisions seem clear-cut, they raise a plethora of issues for a lender, servicer, and trustee to consider when moving for fees. We recommend analyzing your DOT at the outset of any litigation to determine whether you can ultimately recover your attorney's fees should you ultimately prevail. Even if you never end up filing the fee motion, knowing your options is useful when negotiating with the other side or during a mediation. DS