MUST CALIFORNIA LENDERS PAY INTEREST ON INSURANCE PROCEEDS?

NO, ACCORDING TO THE RECENT DECISION IN *GRAY V. QUICKEN LOANS*

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California is among seventeen states that require a lender to pay interest on a mortgage loan's impound or escrow account.[1] California's interest on impound account law covers money received in advance for payment of taxes, insurance or other purposes relating to the property.[2] However, because of the law's broad language, many consumers have been demanding interest on hazard insurance proceeds held in escrow accounts. And, there is no shortage of websites suggesting that such claims to interest can be pursued. California's often hot and dry weather conditions, resulting in wildfires which can lead to billions of dollars in property loss, potentially set the stage for increased demands and litigation.

Following the record setting 2020 wildfire season,[3] California's appellate court quenched the flares of demand for interest on hazard insurance proceeds, held in escrow as a result of damage to property, and clarified in the first published opinion on this subject, that **the law does not apply to such insurance proceeds.** *Gray v. Quicken Loans, Inc*., (2021) 61 Cal. App. 5th 524.

California's Interest on Impound Account Law

Enacted in 1976, California's interest on impound account law in *Civil Code* §2954.8, requires that a financial institution making or purchasing loans secured with real property containing a one -to four- family residence, that receives money in advance for payment of taxes, assessments, insurance or other purposes relating to the property, to pay at least a 2 percent simple yearly interest, which shall be credited to the borrower's account annually or upon termination, whichever is earlier. The law is part of *Civil Code* §2954 series, which govern the establishment of impound account for payment of taxes, insurance and related charges, and require among others, that a beneficiary or loan servicer provide a statement to the mortgagor, at the end of each calendar year, showing the moneys received, held and disbursed from an escrow account, and any interest credited to the account.

The very timely case of *Gray v. Quicken Loans, Inc.*

The case of *Gray v. Quicken Loans, Inc*., (2021) 61 Cal. App. 5th 524, arose from the Thomas wildfire that affected Ventura and Santa Barbara counties in December 2017. At the time the Thomas Fire was the seventh most destructive wildfire in state history, however, after the 2020 wildfire season, it now ranks as the tenth most destructive.[4] In the *Gray* case the Thomas Fire destroyed the home and the insurance company jointly paid the homeowner and mortgage lender, a total of $1,342,740. The *Gray* Deed of Trust contained the standard language in a residential Deed of Trust that the lender has the right to hold such insurance proceeds, and to disburse them for repair. And, unless an agreement is reached in writing or the applicable law requires, lender shall not be required to pay borrower interest on such proceeds.

The *Gray* homeowner filed a putative class action, alleging breach of *Civil Code* §2954.8, for failure to pay interest on the insurance funds held in escrow. The homeowner argued that the hazard insurance proceeds were paid and received "in advance of rebuilding," and thus, were subject to California's interest in impound account law.
Given the lack of any prior appellate case on this subject, the appellate court in *Gray* turned to the unpublished district court case of *Lippitt v. Nationstar Mortgage, LLC*, 2020 U.S. Dist. LEXIS 122881 for guidance.[5] *Lippitt*

[1] According to Investopedia.com, the other sixteen states are Alaska, Connecticut, Iowa, Maine, Maryland, Massachusetts, Minnesota, New Hampshire, New York, Oregon, Rhode Island, Utah, Vermont and Wisconsin.
[2] *Civil Code* §2954.8.
[3] See https://en.wikipedia.org/wiki/2020_California_wildfires.
[4] See https://en.wikipedia.org/wiki/Thomas_Fire.
[5] As an unpublished federal district court case, the holding in *Lippitt* is not binding, but may be cited as persuasive.

was another putative class action against a lender for failure to pay interest on deposits of insurance proceeds for property owners who had their homes damaged or lost in a natural disaster. The *Lippitt* homeowner had requested that the lender pay 2% simple interest on the insurance proceeds held in escrow, and lender had informed the homeowner that there was no such obligation to pay interest on the insurance funds. The dispute in *Lippitt* centered on whether hazard insurance proceeds are received "in advance" of rebuilding.

The *Lippitt* court reasoned that"…[t]he Insurance Proceeds are "received" as compensation for property damage that has already occurred, and the purposes for which the Insurance Proceeds "shall be applied" depend on factors that are not determined in "advance" of the Insurance Proceeds' initial disbursement." *Lippitt* at p. *20. The *Lippitt* court analyzed the Deed of Trust language in light of *Civil Code* §2954.8, and concluded that the interest on impound account law does not apply to hazard insurance proceeds, which are funds received in arrears for past losses and held for specified purposes. Simply put, hazard insurance funds received after the insured loss fall outside the scope of California's interest on impound account law, which applies to moneys received in advance for payment of taxes, assessments, insurance and other purposes relating to property.

The appellate court in *Gray* agreed with the reasoning in *Lippitt* and held that *Civil Code* §2954.8 "[a]pplies to common escrows maintained to pay taxes, assessments, and insurance premiums – not to the comparatively unique example of hazard insurance proceeds held by a lender pending property rebuilding." *Gray* at p. 528, 529 (internal citation omitted).

Conclusion

California's interest on impound account law has been the subject of recent litigation activity, notably in the form of putative class actions. In 2018, in the putative class action case of *Lusnak v. Bank of Am., N.A.*, 883 F.3d 1185, the Ninth Circuit Court of Appeals held that the National Banking Act does not preempt *Civil Code* §2954.8.

In 2020, in the putative class action case of *McShannock v. JPMorgan Chase Bank, NA*, 976 F.3d 881, the Ninth Circuit Court of Appeals held that the Home Owner's Loan Act of 1933 ("HOLA") preempts *Civil Code* §2954.8, for loans originated by a federal savings association, organized and regulated under HOLA, even after a loan transfers out of the federal savings association.

The *Gray* case, also brought as a putative class action, is the first published appellate opinion deciding that *Civil Code* §2954.8 does not apply to hazard insurance proceeds received as a result of damage to property. Given California's record breaking 2020 wildfire season, the case could not have been timelier in quenching the flares of demands to pay interest on hazard insurance proceeds, and keeping the flares from turning into putative bonfires.

If you have any questions regarding this topic, please do not hesitate to contact Robert Finlay at rfinlay@wrightlegal.net or Kathy Shakibi at kshakibi@wrightlegal.net.

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