I'm Over Moon

All the Questions You Ever Wanted (or Didn't Want) to Ask About the *Moon* Case

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Does it feel like you've been thinking about the Moon a lot, and not the big round rock in the sky? Brokers, lenders, and servicers have been considering the effects of the *In Re Moon*[1] case since the decision came down in 2022. This article will not delve into the *Moon* case and its holding – that has been handled very competently in other articles. Instead, this article will address some common questions that have been posed in the wake of the *Moon* case.

Moon Holding:

The court in the *Moon* case interpreted Cal. Civil Code § 1916.1 as requiring that a modification, extension, or forbearance is exempt from usury under the "real estate broker exemption"[2] only if the broker had acted as a broker in the selling, buying, leasing, exchanging, or negotiating the sale, purchase, lease or exchange of real property or a business in the loan transaction.[3] For purposes of private mortgage lenders, the court appears to hold that not only must a real estate broker negotiate the loan, but the *same* broker must also negotiate the modification, extension or forbearance, and that broker must also be the broker who negotiated the purchase or sale of the property. This leaves the question of what happens when the loan was refinanced? Under a strict reading of the court's ruling, it seems that no broker would meet the criteria of Civil Code 1916.1, and therefore no modification, extension, or forbearance of the refinance would qualify for the broker's exemption from usury.

> NOTE: nothing contained in this article should be considered as legal advice or relied upon as legal advice. Please consult with your preferred counsel before entering any agreement that could implicate the *Moon* holding.

COMMON QUESTIONS:

If I am a California Finance Lender ("CFL"), does *Moon* apply to my loans?

The answer to this is more complicated than it seems at first blush. If a CFL licensee makes a loan and services it, it is not covered under Civil Code 19161.1 and the *Moon* case. If a CFL licensee makes a loan, and then an REB licensee services the loan, there is an argument that the transaction is covered under 1916.1, and therefore covered by the *Moon* case. Before running out and getting a CFL license or using your existing CFL as the rationale for disregarding the *Moon* case, it is best to talk with your counsel.

Can I charge points and fees & lower the interest rate to below 10%?

You can, but the points and fees may be considered when determining the rate of interest for purposes of the usury rate. Therefore, be careful of lowering the rate to below 10% and then steeply raising the points and fees.

If the interest rate on the loan is 10%, the loan is not usurious, right?

In most instances, the usury limit is 10%. But it is generally safer to stay under 10% in case there is some margin for error.

Can I just have the borrower sign a 6 month extension – not changing the terms at all except the maturity date?

Unfortunately, extension of the loan is specifically mentioned in Civil Code §1916.1,

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and therefore, is subject to the *Moon* decision. As a result, having the borrower sign a 6-month extension when the loan rate exceeds the usury rate could be risky, unless the loan was a purchase money loan, and the broker arranging the extension is the same broker who arranged the purchase of the property.

What if I write the option to extend into the original loan documents?

This may work, but there are risks. The idea is that the terms of the extension are written in as part of the loan, so that there is no after-closing extension agreement. The more automatic the extension, the lower the risk that the extension will be considered a separate extension and therefore subject to *Moon*. However, risks include: (1) that your lender may be locked-in to giving the borrower an extension when they would rather not; or (2) that a court would find that the extension violated *Moon*. Seek the advice of counsel before implementing this to make sure you understand all of the risks.

I'd rather take my chances and extend the loan with a rate over 10% – most borrowers don't sue and if they do, I just get a lower interest rate, right? What's the harm if I just do it anyway!

If your loan is found to have violated the usury limit, the penalty is not just a lower interest rate. You may lose all of the interest and interest paid to date could be ordered applied to your principal. Also, usury could be considered a crime under some circumstances.

Does default interest that takes a loan over 10% IR violate *Moon*?

This question appears to be conflating two recent cases, *In Re Moon*, which pertains to the DRE broker exception from usury for loan extensions or modifications arranged or made by DRE licensed brokers, and the *Honchariw* case, which pertained to the ability to charge pre-maturity default interest rates on the entire unpaid principal balance of the loan. So, let's break it down:

1. Read narrowly, *Moon* requires that, in order for an extension, modification, or forbearance to be exempt under the broker exemption from the usury limit of 10%, the broker who makes or arranges the extension, modification or forbearance must be the same broker who arranged the sale of the property. In that respect, if a default rate is in effect and the default rate is under 10%, the *Moon* case is inapplicable, because the interest rate is under the usury level. If there is a default rate above 10% on the loan, but the note rate is under 10%[4], and the default rate is not in effect, then the extension, forbearance or modification is not subject to the *Moon* holding.

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2. But that doesn't necessarily mean that default interest is allowed. The court in the Honchariw case stated that charging pre-maturity default interest on the unpaid principal balance is an impermissible penalty, and therefore unenforceable. So, if the lender modifies a loan, and the loan has a default rate, and there is a pre-maturity default, the lender would still be prohibited from charging the default interest on the entire unpaid principal balance. It could make a difference if the default rate is not very high, because there is a greater chance that the default interest could be construed as being reasonably related to the amount of damages suffered by the lender as a result of the default, and not an impermissible penalty. The most conservative approach is still to refrain from charging pre-maturity default interest on the unpaid principal balance of the loan.

Can I just foreclose on the loan?

Absolutely. The safest route is just to foreclose. But lenders generally don't want to foreclose, which is why you are working with the borrower to begin with.

Does postponing a foreclosure sale violate Moon?

Merely postponing a foreclosure sale, without any sort of agreement with the borrower, should not violate the *Moon* case. In general, lenders should be careful to refrain from verbally promising anything to the borrower regarding a postponement or workout. Verbal promises could be: (1) considered an oral modification agreement; and/or (2) subject to misinterpretation or misrepresentation by the borrower. To be safe, lenders can send a "reservation of rights" letter to the borrower if the foreclosure sale is postponed, so that: (a) the borrower knows that the sale has been postponed; (b) the lender is not waiving any rights under the loan documents by postponing the sale; and (c) the lender reserves any rights it has to enforce the loan documents.

Is there a legislative solution to the problem?

Yes! Help is hopefully on the way. Your California Mortgage Association drafted language to resolve the issue. Our longtime Lobbyist, Mike Belote, found Senator Wilk to sponsor Senate Bill 1146. With Mike's guidance, SB 1146 is working its way through the Legislature. We are optimistic that it will pass, creating a solution starting January 1, 2025. Until then, lenders still have to navigate the issues outlined above.

Navigating loan defaults under the *Moon* and Honchariw cases can be confusing. Lenders and servicers are encouraged to seek the advice of their preferred counsel when drafting their policies and procedures regarding modifications, extensions, forbearances, and also default interest and when negotiating with borrowers.

If you have any questions on this issue, please feel free to contact Michelle Rodriguez at mrodriguez@wrightlegal.net or Robert Finlay at rfinlay@wrightlegal.net.

Endnotes

1 *Moon v Milestone Fin. LLC* (*In Re Moon*), 639 B.R. 190, January 31, 2022.

2 Cal. Const, Art. XV §1

3 *Moon* at 200.

4 The usury law applies to loans with a rate above 10%, so technically, if the rate is 10% it should not violate the usury law. But I recommend that a lender concerned about usury set the rate slightly under 10% to allow for errors in calculation.

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