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VOICES

Fallout from Foreclosure Ruling Could Strangle Housing Market



By T. Robert Finlay
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One of the most anticipated recent decisions, for anyone involved with nonjudicial foreclosures in California, was the state's Supreme Court review of *Yvanova v. New Century Mortgage Corporation*. The narrow opinion the Court ultimately issued has the potential to plague other courts, and the housing market, with ongoing problems it simply declined to address.

Yvanova tackled the crucial issue of whether (and when) a borrower can challenge the right of an entity who claims to have acquired their loan from the original lender to enforce the note and deed of trust. The borrower will sometimes even attack the right to collect the monthly payments on the loan or, more typically, dispute the new entity's right to foreclose on the real property securing the loan.



IMAGE: Fotolia

Essentially, despite expounding on the issues for 30 pages, the *Yvanova* opinion simply stands for the unremarkable (and, largely, undisputed) proposition that a borrower can sue for wrongful foreclosure where the transaction by which the beneficiary acquired the loan was void to begin with. That narrow holding has been misconstrued by borrowers' counsel, and by some in the financial industry, who read much more into the Court's decision than is actually in there.

As framed by the Supreme Court in its order, the sole issue up for review in *Yvanova* was whether, in a lawsuit for wrongful foreclosure on a deed of trust securing a home loan, the borrower has standing to challenge an assignment of the note and deed of trust by the original lender, or its agent, to a successor entity on the basis of defects allegedly rendering the assignment void.

Lenders, servicers, trustees and even borrowers (and their attorneys) were all hoping for, if not expecting, the Court to provide clear guidance, and perhaps even issue a final ruling on the issue of standing.

Unfortunately, we were all doomed to disappointment. Despite extensive briefing on both sides, concerning the necessity — and possible consequences — of the Court definitively ruling on the issue, the Court's opinion instead explicitly stated that its ruling on the case should be considered very narrow, and that only a borrower who has dealt with a nonjudicial foreclosure does not lack standing to sue for wrongful foreclosure, merely because he or she was in default on the loan.

The decision continued, emphasizing that the Court did not intend its decision to be read as an approval of the filing of lawsuits by borrowers before there was a foreclosure sale based on the borrower's questioning the rights of the successor entity to enforce the note and deed of trust; nor even that *Yvanova's* plaintiff had or could prove that the transfer to the successor entity in her case was void. The Court also stated that its rejecting the defendants' arguments based on standing was not intended to address whether the borrower had properly pleaded the substantive elements of wrongful foreclosure tort or any facts required to meet those elements. All it did was open the courthouse door for a borrower whose home had been foreclosed upon to try to make the claim that the successor entity had no right to do so.

What the Supreme Court specifically avoided doing was to provide any clarity, or even guidance, on key elements of borrower lawsuits.

The Court also declined to consider any of the factual arguments made by the financial institutions to show that, in this particular case, the transaction was voidable. Oddly, the Court did not address the purely legal issue (argued in the briefs) of whether an assignment needs to be recorded at all to transfer the loan. These issues were left to the lower courts to determine in individual cases.

What the Court did do, though, that might prove troublesome in cases still pending or yet to be filed, is reject the defense arguments that other, lower court cases had sometimes relied upon. These include: it is irrelevant to the borrower who is enforcing the debt; there is no harm/prejudice to the borrower from the "wrong party" foreclosing if the loan is in default; the borrower must show that the

"true" owner would have refrained from foreclosing; and borrowers lack standing to challenge an assignment as void because they are not parties to the assignment.

Defense teams will need to shift away from those arguments to other issues, some of which might pose more factual questions that usually cannot be resolved at the pleading stage — though, as the Supreme Court itself noted, the standards for standing in the federal and state systems are not identical.

Thus, a potentially fruitful option to have a lawsuit struck down early in the process could be removing the case to federal court, given the stricter pleading standards imposed on plaintiffs by the federal system.

The impact of the Supreme Court's ruling on the lending and foreclosure industries — and the courts — in California will likely be significant. The uncertainty around the unresolved issues will undoubtedly lead to more litigation and confusion and create far greater expense for borrowers, lenders, servicers and foreclosure trustees.

It will also, inevitably, further inundate an already over-burdened court system.

Financial institutions are already seeing an increase in claims by borrowers that they fit under the *Yvanova* decision and are entitled to sue — even in cases having nothing to do with securitizations or borrower standing to sue. This is occurring even in cases that the financial institution may have already won.

The next big battle is likely to be over the attempt to extend *Yvanova* to preforeclosure claims, presumably arguing that the same analysis should apply with even greater force before a sale, when the borrowers can still "save" their homes. Borrowers will also likely point to the [California Homeowner Bill of Rights](#) as support for their arguments, while the financial institutions will rely on the lack of specificity in the borrowers' complaint and the policy of deferring to the Legislature for any changes to the nonjudicial foreclosure laws.

From those assertions, the court should be able to determine as a matter of law whether a particular transaction is void or voidable. The court should also be able to weigh in on the line of cases saying that the Legislature, not the courts, decides whether to impose additional requirements on nonjudicial foreclosure. However, the courts might be more reluctant to do so at the early, pleading stage of a lawsuit, thus increasing the time and expense of a final resolution.

The potential effects of the *Yvanova* decision could also cut a wide swath through the housing and mortgage markets. Lenders could be faced with tighter underwriting standards to reduce the risk of borrower default. The secondary market, meanwhile, would see a drop in investors willing to take on the risk of mortgage loans, which would further dry up funding sources. An increased risk of borrower default as borrowers find it harder to obtain new credit, will compete with other less scrupulous borrowers "gaming the system" to continue living in properties they are no longer making payments on. Fewer foreclosed properties would mean a decrease of available housing in an already-squeezed market. Any properties on which borrowers have stopped making payments are also less likely to be properly insured or maintained, which results in increased blight and property hazards. This, of course, forces the local government and financial institutions to bear the burden to fix them.

Thus, the opinion the California Supreme Court ultimately issued here might well cause more problems than it has solved.

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