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BY AUSTIN KILGORE | PAGE 26

The Mabry hurdle

California court ruling eliminates REO obstacle

BY ROBERT FINLAY AND JENNIFER JOHNSON

Thanks to the recent court of appeals decision in "Mabry v. Aurora Loan Services LLC, et al," one of the many legal hurdles preventing REO properties from being available for sale has fallen, at least for now. During the last several years, the California Legislature has been busy trying to reduce the number of homes that enter the foreclosure process. One such effort was SB 1137 (which was passed in July 2008, and became operative as of September 6, 2008.) The result of this legislation, California Civil Code §2923.5, has made thousands of properties in the state the subject of lawsuits, delaying their sale in the REO market.

LEGISLATION

SB 1137 was passed to prevent unnecessary foreclosures. The California Legislature believed, perhaps naively, that their goal could be achieved by requiring lenders (or, more realistically, their servicers) to contact borrowers in default prior to recording a notice of default.

During the contact, the borrower and servicer are to try to work out a loan modification or some other type of agreement that would allow the borrower to remedy their default and avoid foreclosure. Specifically, the lender is required to "assess" the borrower's financial situation, "explore" options to avoid foreclosure, and provide the telephone number for HUD-certified housing counseling agencies.

Does this mean that a borrower could prevent the recording of the notice of default (the first document necessary in the foreclosure process) by simply avoiding the lender's call? Thankfully, no. The bill lays out a framework of what is to be done if the lender cannot reach the borrower by phone, which includes sending letters and repeatedly attempting to contact the borrower by phone. After weeks of such attempts, the lender has exerted the necessary "due diligence" and may proceed with the foreclosure process.

Once the "contact" step has been completed, the lender may instruct its agent or the trustee to record the notice of default. The notice of default must include a "declaration" stating that the lender, or its agent, has contacted the borrower, has tried with due diligence to contact the borrower, or that no contact was required because one of the exceptions outlined in Civil Code § 2923.5(h) applied. (There are exceptions to the contact requirement if the borrower has surrendered the property, contracted with a person or organization advising the borrower on how to extend the foreclosure process and avoid their obligations under their loan, or has filed a bankruptcy case.)

Seem clear to you? While the idea of what needs to happen is simple — call the borrower and try to work out a solution — the reality is anything but.

LITIGATION

Thousands of properties in the State of California are now the subject of lawsuits where the borrowers are claiming that a pending or completed trustee's sale is or was "wrongful" because: (1) the lender did not fulfill the contact requirements of Civil Code § 2923.5 prior to recording the Notice of Default, (2) the 2923.5 declaration was not signed under penalty of perjury, and (3) the declaration repeated the statutory language regarding the form of compliance — did the lender/servicer contact the borrowers, make a due diligence effort to contact the borrowers, or did an exception apply — instead of indicating which of these three categories applied to the specific loan.

In our experience, in the great majority of these cases, the lenders/servicers have fully complied with the contact requirement of Civil Code § 2923.5. That does not prevent borrowers (or, perhaps, their attorneys) from claiming otherwise in an attempt to delay the sale of the property, or stop an eviction proceeding.

STRETCHING OUT THE LITIGATION

Civil Code § 2923.5 is a pre-foreclosure requirement. This means that the statute must be complied with before a notice of default can be recorded. As a result, borrowers have the full 110-day foreclosure period to take action if they feel that their lender did not contact them to explore alternatives to foreclosure.

This seems like a reasonable safeguard to prevent last-minute confusion as the sale date approaches. However, complaints and requests for temporary restraining orders are typically requested on the eve of the sale.

In the alternative, the sale has already taken place and the borrowers are trying to prevent the lender from evicting them and/or selling the property to a third party. Either way, instead of resolving the allegations while the notice of default is seasoning, it adds time to the back-end of the process and delays the transition from pre-foreclose to REO inventory.

Because Civil Code § 2923.5 is so new, trial courts throughout California were making inconsistent rulings as to the technical requirements of the statute, as well as what relief the California Legislature intended to allow if a lender actually violated the statute. Until an opinion was published by a court of appeals or the California Supreme Court, the requirements and impact of Civ-

il Code § 2923.5 seemed to depend on which judge heard the case. This brings us to the Mabry case.

THE MABRY CASE AND DECISION

The Mabry case follows the typical pattern for Civil Code § 2923.5 litigation. Michael and Terry Mabry refinanced their home in Corona, Calif. in December 2006, borrowing $688,000. They began missing payments in August 2008.

According to the servicer, they had frequent contacts with the Mabrys both before and after their default, discussing options to avoid foreclosure, including loan modification, short sale, deed-in-lieu of foreclosure and a special forbearance agreement. The servicer contends that these contacts, as well as a number of attempted contacts, fulfilled their obligations under Civil Code § 2923.5. (According to Michael Mabry's declaration, the Mabrys were never contacted by the servicer in person, by telephone, or by mail to explore foreclosure alternatives.)

All of the necessary steps were taken and the foreclosure was moving along. Then, one week prior to the scheduled sale, the Mabrys filed a suit, alleging, among other things, that they were never contacted as required by Civil Code § 2923.5, and that the declaration contained in the notice of default was defective because it was not signed under the penalty of perjury and did not detail which of the three options applied — did the servicer make contact, try to contact them, or did an exception apply? Based on these allegations, the Mabrys asked the court to stop the foreclosure sale. After granting a brief temporary restraining order, the court denied the Mabrys' request for a preliminary injunction, and the lender was free to proceed with the sale. In order to prevent the sale, the Mabrys filed a writ of mandate in the Court of Appeals of the State of California, challenging the lower court's order denying injunctive relief.

In the appeal, our office filed an amicus curia brief on behalf of the United Trustees' Association and California Mortgage Association, advocating on behalf of the mortgage and trustee industries. The Court of Appeals granted the writ in part, clarifying the impact of Civil Code § 2923.5 and several of its technicalities. Specifically, the Court of Appeals held in a published decision that borrowers have a private right of action and that federally regulated entities are subject to its requirements, but the private right of action is limited to postponing the sale until the lender has fulfilled the contact requirements.

The court reinforced that there is no right to a loan modification, and that all a lender needs to do to "assess" the borrower's financial situation is to merely inquire as to why the borrower has not made his or her loan payments, and all the lender needs to do to "explore" options to avoid foreclosure is to simply recite the traditional ways that foreclosure may be avoided. Under Mabry, a lender has no obligation to offer a loan modification, or even take information for a loan modification over the phone.

The court went on to address the technical aspects of Civil Code § 2923.5 whereby it held that the declaration contained in the notice of default does not need to be signed under the penalty of perjury, and it is sufficient to regurgitate the statutory language without delineating which of the three categories (contact, due diligence, or exception) applied in the specific case.

Finally, and most importantly for the REO community, the court held that alleged violations of Civil Code § 2923.5 cannot be used to challenge title to property following the foreclosure sale. This means that all of the properties being tied up in litigation based exclusively on alleged violations of Civil Code § 2923.5 should be quickly making their way to becoming active listings. Should be.

REO IN POST-MABRY

It seemed like we were on our way to a happy ending. So close! While writing this article, the Mabrys filed a petition for review with the Supreme Court of California, arguing that REO properties should not be immune from borrowers' Civil Code § 2923.5 claims because the lenders that purchase the properties at the trustees' sales are aware of their own (alleged) violation of the statute. Now we wait to see if the Supreme Court grants review. For now, the REO inventory is free to go. For now. R

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