

To Preempt or Not to Preempt: That is the Question that Courts are Facing with California Civil Code Section 2923.5

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California Civil Code section 2923.5, which took full effect on September 6, 2008, is the subject of many lawsuits in California. It requires that 30 days prior to filing a notice of default, a mortgagee, beneficiary, or authorized agent contact the borrower in person or by telephone in order to assess the borrower's financial situation and explore options for the borrower to avoid foreclosure or try with due diligence to contact the borrower. However, federal savings associations ("FSAs") are already governed by federal law – the Home Owners' Loan Act of 1933 ("HOLA"). The courts have now begun to rule on whether 2923.5 as applied to FSAs is preempted by HOLA, section 560.2 of title 12 of the Code of Federal Regulations.

HOLA states that the Office of Thrift Supervision ("OTS") is authorized to promulgate regulations that preempt state laws affecting the operations of FSAs. 12 C.F.R. § 560.2(a). Section 560.2(b) of HOLA goes on to provide examples of state laws that are preempted, including, laws purporting to impose requirements regarding "(10) Processing, origination, servicing, sale or purchase of, or investment or participation in, mortgages." On the contrary, section 560.2(c) of HOLA discusses state laws that are not preempted to the extent that they only incidentally affect the lending operations of FSAs, namely "(2) Real property law."

Both the state and federal courts seem to go through the same basic preemption analysis, which is discussed below, but they differ in their conclusions reached based on this analysis – with the state appellate court concluding that 2923.5 as applied to FSAs is not preempted by HOLA and the federal district courts concluding that it is clearly preempted.

The preemption analysis begins with whether the state law falls within one of section 560.2(b)'s explicitly preempted categories, the significant category being laws which impose requirements regarding the servicing of mortgages. The California Court of Appeal in *Mabry v. Superior Court*, ruled that 2923.5 does not fall under this preempted servicing category. The state court in *Mabry* found that mortgage foreclosure laws have traditionally been governed by the state. Therefore, "if the Office of Thrift Supervision wanted to include foreclosure as within the pre-empted category of loan servicing, it would have been explicit." *Mabry*, 185 Cal. App. 4th 208, 231 (June 2, 2010). The district court in the Southern District of California ruled differently in *Quintero Family Trust v. OneWest Bank, F.S.B.* The court in *Quintero* found that "the state law's requirements dealing with contacting the borrower and

including a specific declaration in the Notice of Default fall squarely within the scope of HOLAs Section 560.2(b)(10), which deals with the “[p]rocessing, origination, servicing, sale or purchase of, or investment or participation in, mortgages.” Quintero Family Trust, 2010 WL 2618729 at 6 (June 25, 2010).

Of course, if the court finds that 2923.5 falls within a preempted category, it is preempted and the analysis ends there. However, if the court determines that 2923.5 is not expressly preempted, the next question is whether the law affects lending, and if so, there is a presumption that the law is preempted. OTS, Final Rule, 61 Fed. Reg. 50951, 50966-67 (Sept. 30, 1996). This presumption can only be reversed if the law clearly falls under one of the exemptions listed under section 560.2(c) of HOLA. *Id.* Any doubt should be resolved in favor of preemption. *Id.* The district court in the Southern District of California found that “state laws governing foreclosure proceedings affect lending,” and thus, the presumption arises that 2923.5 is preempted by HOLA. *Giordano v. Wachovia Mortgage*, case no. 5:10-cv-04661-JF (December 14, 2010).

Now the question is whether 2923.5 falls under an exemption listed under section 560.2(c) of HOLA, the significant one being real property laws to the extent that they only incidentally affect the lending operations of FSAs. The court in *Mabry* found that the process of foreclosure has traditionally been a matter of state real property law, which is an exempted category. *Mabry* at 230. The court found that the state law is not preempted and does not affect the “integrity” of the basic debt as long as relief under 2923.5 is limited to just postponement of the sale. *Mabry* at 231-32. The federal court in *Giordano* disagreed with the state appellate court in *Mabry*, stating, “even assuming the limited construction of § 2923.5 proffered by *Mabry*, a state statute that imposes additional disclosure and communications obligations upon a lender prior to commencement of foreclosure proceedings is not ‘incidental’ to lending.” *Giordano* at 7. Thus, this court concluded that 2923.5 is in fact preempted by HOLA.

As you can see, there is a serious conflict among state and federal courts as to whether 2923.5 is preempted by HOLA. FSAs must now wait for the higher courts to decide the issue. Until then, they face conflicting rulings in California courts.

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