Lona v. Citibank – Unconscionable or Oppressive Loan Origination

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The facts of this case may sound familiar as they are fairly common. A borrower refinances his $1.24 million loan, only to default after five monthly payments. A Notice of Default is recorded, followed by a Notice of Trustee's Sale and finally a Trustee's Deed Upon Sale is recorded just shy of one year after the foreclosure began.

Post-foreclosure, the borrower/plaintiff sues to set aside the foreclosure due to, among other things, "predatory lending." In short, Plaintiff alleges that the loan was invalid because the loan broker ignored not only the fact that plaintiff's income was inadequate to repay the loan, but also that Plaintiff had limited English capabilities. After extensive law and motion, followed by some discovery, the court granted Defendants' Motion for Summary Judgment, finding that no triable issue of material fact exists. Plaintiff appealed, and PREVAILED. The Court of Appeals remanded the case back to the trial court stating that there were indeed triable issues of fact involving the unconscionability of the underlying loan such that there may in fact be cause to set aside trustee's sale. Furthermore, the Court ruled that the failure to tender was not fatal to Plaintiff's request to set aside the trustee's sale.

At first blush, this is nothing short of a nightmare scenario, a veritable open invitation to every borrower who took out a loan where the monthly payments were in excess of their actual monthly income. But upon closer analysis, it may not be doomsday after all.

The Court of Appeals skimmed over some of the more disturbing discrepancies on the record, including that Plaintiff knowingly signed off on his loan application, indicating income of approximately $20,000.00 a month yet during the lawsuit claimed that at all relevant times his income was only $40,000.00 a year. Instead, the Court concentrated on two main issues: (1) was there a triable issue of fact regarding the unconscionability of the loan; and (2) must Plaintiff tender to cure the default as a pre-condition to setting aside the foreclosure sale.

Unconscionable? Really?

On the question of unconscionability, the Court concluded that under current California law it can refuse to enforce a contract or a portion of a contract that is unconscionable as a matter of law. The analysis of whether a loan contract may or may not be found to be unconscionable comes down to a two part test. (1) Is the loan contract one of adhesion? If yes, then, (2) is the contract unduly oppressive? Only when both of these factors are present, can a court find that a contract is unconscionable and, therefore, unenforceable.

Adhesive Contracts

There is little debate that the majority of, if not all, consumer residential loans today are contracts of adhesion. An adhesive contract is generally a standard form contract, drafted by the stronger of the parties (i.e., lender), where none of the terms are open for negotiation. An adhesive contract is generally one which the weaker party (the borrower) can either take it or leave it.

Unduly Oppressive

The Lona Court describes the "unduly oppressive" element of the analysis as the "substantive" element, requiring another two-part inquiry. First, does the contract fall within the "reasonable expectations of the weaker or "adhering" party?" The second part of the inquiry comes full circle and requires a court to consider whether the contract "when considered in its context" is unduly "oppressive."

Ignoring the clearly circular nature of the Lona Court's analysis, at the end of the day, or at least near the end of the opinion, the Court's final reasoning for overturning the Order for Summary Judgment was based solely on the Defendants' failure to submit sufficient evidence into the record to support their position on unconscionability. The Court noted that the Second Amended Complaint alleged that the loan was unconscionable because it was made "without reasonable consideration of his ability to repay the loans . . . given his income at the time" and that the interest rate "far exceeded what was reasonable given his credit rating at the time of the application," and that Defendants did not assert any evidence to counter these claims. The ruling is not, therefore, a sanction in favor of borrowers' unconscionability claims that could lead to a floodgate of new borrower suits. Instead, it is a lesson to defense counsel to attack each and every allegation in the complaint when moving for summary judgment.

Tender and the Trustee's Sale.

Contrary to the roundabout reasoning in the unconscionability analysis, the Lona Court did make two things clear: (1) that under California Civil Code section 2924 et seq. a trustee's deed creates a rebuttable presumption that the sale was proper; and, (2) that a Plaintiff still must tender, or offer an excuse to tender, as a condition of setting aside a foreclosure.

The court reiterated the holdings in Knapp v. Doherty and Moeller v. Lien that a trustee's deed which "recites that all statutory notice requirements and procedures required by law for the conduct of the foreclosure sale have been satisfied, a rebuttable presumption arises that the sale has been conducted regularly and properly; this presumption is conclusive as to a bona fide purchaser." Thereby, reinforcing that a trustee's sale shifts the burden to Plaintiff to establish irregularities in the foreclosure process.

Just as important, the Lona Court reiterated that an action to set aside a trustee's sale is in equity, and therefore there is a requirement to do equity first. The fact that the Lona Court did not require Plaintiff in this case to tender was based on the specific facts of this case. Namely, Plaintiff's allegations fell within one of the noted exceptions to the Tender Rule - where the plaintiff is attacking the validity of the under debt.

Summary

After a closer reading, it is apparent that the Lona ruling does not open the door for every borrower to march through with claims that their loans are unenforceable because they were unconscionable. Rather, this decision laid out, however vaguely, an analytical framework for a claim for unconscionability of a loan contract, which plaintiffs must carefully navigate to be successful. A framework which also includes multiple defensive opportunities.

Moreover, where the Lona ruling seemingly eviscerated the tender requirement, a closer investigation reveals that the Court only revisited the traditionally accepted exceptions to tender, and in so doing actually reinforced the requirement that a borrower challenging the foreclosure sale must make a valid tender as a condition of maintaining his or her action.