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A California-Brewed Recipe For Litigation

Borrowers are challenging servicers' interpretation of Civil Code Section 2923.5, asking the courts to put form over substance in focusing on technical execution.

by Robert Finlay

As many readers may recall, the California Legislature enacted Civil Code Section (§) 2923.5 in July 2008, requiring that the foreclosing party contact the borrower in an attempt to work out a loan modification prior to initiating foreclosure.

The purpose of the legislation was to avoid any unnecessary foreclosure sales in an attempt to stabilize California's hard-hit housing market. A year and a half later, borrowers who are either unable or unwilling to modify their loans are filing lawsuits at an alarming rate over perceived technical violations of §2923.5 in an effort to delay foreclosures.

Legal challenges

Civil Code §2923.5 was designed to slow down the foreclosure process and ensure that borrowers have an opportunity to discuss foreclosure alternatives with servicers. In substance, §2923.5 did not require servicers to do anything that they were not already doing; instead, it required that the borrower contact take place in a specific manner. The methods of complying with §2923.5 have been discussed ad naseum in prior articles and internal servicing meetings. The purpose of this article is not to rehash the compliance issues, but to discuss the litigation that §2923.5 has spawned.

Many borrowers are trying to take advantage of this opportunity not by seeking a loan modification, but rather by challenging the form of the declaration attached to or included in the notice of default. Specifically, borrowers are claiming that the §2923.5 declaration must be signed under the penalty of perjury and that it must specifically identify the method of compliance with §2923.5 (i.e., whether the borrower was contacted, a due-diligence attempt was made to contact the borrower or that one of the exceptions applied).

This has resulted in further delay in the foreclosure process for the individual borrowers who have filed lawsuits and unnecessary legal fees for the beneficiaries, servicers and trustees concerned with the individual properties. Because efforts by the United Trustees Association to amend §2923.5 have not gotten off the ground, the industry's only chance to clear up the confusion created by §2923.5 and to put a stop to the onslaught of litigation is a published decision from the Court of Appeals. The good news is that we may be close to an appellant decision.

Penalty of perjury

The original version of §2923.5 required a declaration "from" the servicer that it has either contacted the borrower, tried to contact the borrower or that the borrower has surrendered the property. The language in §2923.5 has since been modified to require a declaration "that" the servicer has contacted the borrower, tried to contact the borrower or that one of the exceptions applied. Neither §2923.5 nor its legislative history make any mention that the declaration must be signed under penalty of perjury.

Borrowers argue that because a different statute, Code of Civil Procedure §2015.5, allows a statement made under penalty of perjury to be substituted for a statement that must otherwise be sworn, all declarations must be made under penalty of perjury. While this argument misreads sections 2015.5 and 2923.5, it is often sufficient to confuse judges if the matter is not properly briefed, which is often the case.

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The plain language of §2923.5 does not require that the declaration be made under penalty of perjury. Any court that so holds will be inserting this requirement into the statute. Finding that a notice of default is invalid because the declaration was not made under penalty of perjury would also put form over substance in the cases where the servicer has contacted the borrower or made a diligent effort to contact the borrower but where the trustee failed to execute the declaration under the penalty of perjury.

Finally, as a practical matter, a trustee (the party that normally executes the notice of default) would not have personal knowledge of the servicer's contact, or lack thereof, with the bor-

rower. It is illogical to conclude that the Legislature intended for the trustee to make the declaration under penalty of perjury concerning the conduct of another party.

Borrower contact

Many §2923.5 declarations quote directly from the code section in stating that "the mortgagee, beneficiary or authorized agent has contacted the borrower, has tried with due diligence to contact the borrower as required by [§2923.5] or that no contact was required pursuant to subdivision (h)."

Borrowers filing suit claim that the §2923.5 declaration is deficient if it does not specifically state whether the servicer (a) contacted the borrower, (b) made a diligent effort to contact the borrower or (c) one of the exceptions applied. Again, borrowers are asking the courts to put form over substance in focusing on the technical execution, rather than asking whether the servicer complied with the intent of the statute.

The plain language of the statute does not require this level of specificity in §2923.5(b), but it is important to note that the Legislature did require this level of specificity in §2923.5(c). Courts must assume that the "Legislature knew what it was saying and meant what it said" and, therefore, should not impose requirements that the Legislature intentionally left out.

As previously described, the reason for enacting §2923.5 was to stabilize the California housing market and state and local economies, which the Legislature felt were being threatened by the "skyrocketing residential property foreclosure rate in California." If California courts are swayed by borrowers' arguments and hold that the notices of default recorded since July 2008 are void, the California housing market may be paralyzed by uncertainty. According to RealtyTrac, more than 250,000 trustee sales took place in the state of California in 2009. Title to each of these properties, regardless of whether the property is still held by the foreclosing beneficiary or has since been sold to a third party, could be in question, resulting in the exact opposite of what the Legislature intended when it created 2923.5.

For this reason, and in order to stop the daily filing of new cases challenging the form of the §2923.5 declaration, the industry needs some guidance from the California Court of Appeals.

Help may be on the way. In the case of Mabry v. Superior Court of Orange County, the Court of Appeal, Fourth District, recently accepted a borrower's Writ of Mandate on the exact issues discussed in this article. The Court of Appeals has set a briefing schedule and is accepting Amicus Curiae Briefs from interested parties. An amicus brief has been filed on behalf of the United Trustees Association and the California Mortgage Association. Hopefully, additional briefs will be filed before the matter is heard on the court's May calendar. Until then, the industry will have to continue to face the rising tide. SM

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