LOAN MODIFICATION LAW IN CALIFORNIA

A Review of Recent Loan Modification Cases and Their Impact on the Federal Home Affordable Modification Program

By Harold Justman, Scott D. Rogers, and Henry Chuang

I. INTRODUCTION

In 2008, more than two million different properties received foreclosure notices and banks repossessed more than 900,000 properties.[1] In February of 2009, President Obama announced a mortgage modification program and promised that it would help three to four million homeowners modify the terms of their mortgage to avoid foreclosure.[2] That same day, the Treasury Department released some details of the mortgage modification program.[3] The Treasury would provide fifty billion dollars and Fannie Mae and Freddie Mac would provide twenty-five billion dollars to fund the program.[4]

In the summer of 2009, the Treasury set a goal of 500,000 trial modifications by November 1, 2009.[5] This goal was not to be met. To meet the goal, the Treasury permitted undocumented, verbal trial modifications.[6] Additionally, the Treasury permitted lenders to take preliminary legal steps to foreclose on properties while the trial modifications were being processed.[7] This dual tracking resulted in some homeowners being foreclosed upon only weeks after being told that their loans would not be modified.[8] Dual tracking was subsequently barred by California's Homeowner Bill of Rights.[9]

During 2009, another approximately 2,800,000 properties received foreclosure notices, and banks repossessed another approximately 900,000 properties.[10] By the end of 2009, only approximately 70,000 permanent loan modifications had been completed.[11] In October 2010, the Treasury released a report stating that nearly 700,000 trial modifications had failed and only about 460,000 permanent modifications were successfully ongoing.[12] By the end of 2010, the successful ongoing permanent modifications reached a little more than 500,000, but another approximately 2,900,000 properties had gone into foreclosure, and bank repossessions numbered more than one million.[13] By the end of 2011, the Treasury had spent only three billion of the fifty billion originally allocated to the mortgage modification program.[14] Even by March 31, 2012, there were fewer than 800,000 ongoing permanent mortgage modifications.[15]

In the face of a federal mortgage modification program that was being poorly executed and not accomplishing its stated goal,[16] homeowners in foreclosure in California turned to the courts for meaningful relief. This article will provide a brief summary of recent case decisions that have provided judicial precedents forming a foundation for meaningful contract rights entitling California homeowners to permanent modifications of their home loans. As is discussed in more detail in the case summaries that follow, some recent cases have expanded upon established contract law in order to use extrinsic evidence in the form of Treasury regulations issued under the Home Affordable Modification Program to interpret the conditional terms of forbearance agreements and loan modification agreements and find a binding contract modifying loans that were in foreclosure.

II. THE STATUTE OF FRAUDS AS A BAR TO RELIEF

A. *Rossberg v. Bank of America*

One of the primary obstacles to seeking judicial enforcement of a loan modification is that the statute of frauds bars enforcement of an oral loan modification. The case of *Rossberg v. Bank of America*[17] demonstrates this impediment to judicial relief. In February 2007, Alan and Brenda Rossberg (the "Rossbergs") borrowed $600,000 from Bank of America ("B of A"), secured by a deed of trust against their home in Irvine.[18] Later, the Rossbergs could not make the payments on the loan.[19] The Rossbergs and B of A negotiated for more than two years regarding a modification of the loan against the home.[20] Finally, in September of 2009, B of A recorded a notice of default and election to sell the home.[21] In June 2010, B of A recorded a notice of sale of the home.[22] In April 2011, the Rossbergs sued B of A, claiming that B of A had fraudulently promised to modify the loan against the home and then failed to do so.[23] Nonetheless, B of A completed the foreclosure sale and then in July 2013, B of A obtained a judgment of eviction against the Rossbergs.[24]

The Rossbergs continued to pursue the fraud and breach of contract actions against B of A.[25] The trial judge finally dismissed the Rossbergs' complaint on the ground that it failed to state facts constituting a cause of action.[26]

The Court of Appeal affirmed the judgment of dismissal, holding that the Rossbergs had failed to allege sufficient facts to constitute a cause of action.[27] Regarding the Rossbergs' breach of contract cause of action, the Court of Appeal held that a loan modification agreement must comply with the statute of frauds.[28] Because the Rossbergs failed to allege that a written agreement to modify the loan had been signed by B of A, the breach of contract cause of action failed as a matter of law.[29] Regarding the fraud cause of action, the Court of Appeal held that fraud must be pled specifically; general and conclusory allegations do not suffice.[30] The Court of Appeal pointed out that the Rossbergs failed to allege specific facts showing that they justifiably relied on B of A's alleged misrepresentation that the loan had been modified and that the alleged misrepresentation caused them damage.[31] Moreover, the Court of Appeal questioned whether or not false promises regarding a loan modification that induce a borrower to make payments on a loan which is undisputedly owed can ever constitute damages for fraud, especially when the debtor continues to reside in the home as a result of the continued loan payments.[32] (Further discussion of the heightened pleading requirement for fraud appears in Section III below.)

However, the recent case of *Chavez v. Indymac Mortgage Services*[33] holds out some hope that the doctrine of equitable estoppel can overcome the bar of the statute of frauds.

B. *Chavez:* Equitable Estoppel as an Antidote to the Statute of Frauds

In 1999, Angelica Chavez ("Chavez") purchased a home in San Diego.[34] In 2006, she refinanced the home and obtained a new loan in the amount of $380,000.[35] In November 2009, Indymac Mortgage Services ("Indymac") recorded a notice of default and election to sell pursuant to Indymac's deed of trust.[36] At Chavez's request, Indymac sent a Home Affordable Modification Agreement ("Loan Modification") to her.[37] Chavez signed the Loan Modification and returned it to Indymac.[38] In October 2010, Indymac held a foreclosure sale of the home and in February 2011, evicted Chavez.[39] Chavez then sued Indymac for breach of the Loan Modification and wrongful foreclosure.[40] The trial judge dismissed Chavez's complaint on the ground that it failed to state facts constituting a cause of action.[41]

The Court of Appeal reversed the judgment of dismissal, holding that it was reasonably possible that Chavez could add new allegations to the complaint that would state a cause of action for breach of contract and equitable estoppel preventing Indymac from relying on the defense of the statute of frauds.[42] While acknowledging that a forbearance agreement altering a note and deed of trust is covered by the statute of frauds, the Court of Appeal held that, liberally construed, the complaint sufficiently alleged facts supporting a claim that Indymac should be equitably estopped to rely on the statute of frauds defense.[43] Although the Court of Appeal was not prepared to hold that merely making payments on a debt that a borrower is obligated to pay could raise an estoppel, the Court of Appeal did rule that the fact that the loan modification provided that the unpaid and deferred interest would be added to the outstanding principal, and that interest would then accrue on the unpaid interest, could raise grounds for an estoppel.[44] However, in order for a borrower to prove detrimental reliance justifying a holding of equitable estoppel, the damages suffered by the borrower must be more than nominal.[45]

III. HEIGHTENED PLEADING REQUIREMENT AS A BAR TO RELIEF

A. *Aspiras*: An Illustration of the Requirement

Another obstacle to judicial relief where a trial loan modification has failed is that a fraud claim is subject to a heightened pleading requirement, as was seen in the *Rossberg* case discussed in Section II.A. above. *Aspiras v. Wells Fargo Bank, N.A.*[46] demonstrates the application of this doctrine.

In April 2008, Henry Aspiras and Gloria Aspiras (the "Aspiras") refinanced the loan against their home in San Diego.[47] In January 2009, a notice of default and election to sell the home was recorded.[48] In April 2009, a notice of trustee's sale of the home was recorded.[49] On March 9, 2010, Wells Fargo Bank ("Wells Fargo"), then the holder of the loan on the Aspiras's home, notified the Aspiras by letter that the home loan would not be modified.[50] Mrs. Aspiras claimed that on March 11, 2010 a Wells Fargo employee told her that her loan modification application would be re-opened.[51] On March 18, 2010, the Aspiras had a conversation with Shannon Gordon, a representative of Wells Fargo, who told them the home loan was under review to re-open a loan modification.[52] On the next day, March 19, Wells Fargo sold the home to a third party at a nonjudicial foreclosure sale.[53] The Aspiras promptly sued for fraud, negligent misrepresentation, and violation of the unfair competition law.[54] The trial judge dismissed the Aspiras's complaint, ruling that there were insufficient facts to constitute a cause of action.[55]

The Court of Appeal affirmed the judgment of dismissal.[56] The Court of Appeal gave the Aspiras's fraud claim short shrift by strictly enforcing the heightened pleading standard for fraud claims.[57] Specifically, the Court of Appeal found the complaint fatally defective for failing to identify by name the Wells Fargo employee who allegedly said on March 11, 2010 that the Aspiras's loan modification would be re-opened.[58] The Court of Appeal pointed out that, in asserting a fraud claim against a corporate lender, the Aspiras had the burden to allege the name and authority to speak of the person who allegedly said that the Aspiras's loan modification would be re-opened.[59]

B. Negligent Misrepresentation

The Court of Appeal also relied upon long-standing precedents to affirm dismissal of the Aspiras's negligence and negligent misrepresentation causes of action.[60] As the Court of Appeal pointed out, in California, a lender generally owes no duty of care to a borrower when the lender's involvement in the loan transaction does not exceed the scope of its conventional role as a mere lender of money.[61] Significantly, the Court of Appeal applied this rule to the claim that an employee of the lender negligently misrepresented the status of the loan modification and the foreclosure.[62] As is true of negligence liability, liability for negligent misrepresentations by a bank must rest upon the existence of a legal duty owed by the bank to the borrower. The long-standing rule that a residential lender does not owe any duty of care to a borrower, when applied to statements by a bank regarding the status of a loan modification or a foreclosure, results in a bar to a negligent misrepresentation claim.[63]

However, the case of *Lueras v. BAC Home Loans Servicing*[64] has created a split of authority on this issue.

1. *Negligent Misrepresentation: Court of Appeal Split*

In March 2007, Richard Lueras ("Lueras") refinanced his home loan with BAC Home Loans Servicing, which was later taken over by B of A.[65] In 2009, Lueras requested a loan modification from B of A, and B of A offered Lueras a forbearance agreement that modified the home loan ("Forbearance Agreement").[66] However, in October 2010, a notice of default was recorded against Lueras's home.[67] Lueras immediately contacted B of A about the notice of default.[68] Lueras and B of A engaged in protracted communications regarding the continued modification of the loan.[69] In February 2011, a notice of trustee's sale was recorded against Lueras's home.[70] B of A rescheduled the sale date four times, pending further loan modification communications, but ultimately set the sale for May 18, 2011.[71] On or about May 6, 2011, Lueras contacted a B of A representative in order to confirm the status of his loan.[72] B of A's representative told Lueras that the trustee's sale set for May 18, 2011, would be reset.[73] However, B of A proceeded with the foreclosure. In June 2011, Lueras sued B of A for, among other things, breach of contract, negligence, fraud, and unfair business practices.[74] The trial court dismissed Lueras's complaint on the ground that it did not state facts sufficient to state a cause of action.[75]

The Court of Appeal reversed the judgment of dismissal as to the causes of action for breach of contract, negligence, fraud, and unfair business practices.[76] Regarding the breach of contract cause of action, the Court of Appeal held that a reasonable interpretation of the Forbearance Agreement includes the obligations imposed by the Home Affordable Modification Program ("HAMP"), the federal law designed to avoid home foreclosure.[77] Accordingly, the Court of Appeal held that Lueras could state a cause of action for breach of contract arising from B of A's failure to explore a loan modification with him.[78] The Court of Appeal also found that B of A's written representation that no foreclosure sale would proceed and the oral representation that the foreclosure sale would be reset were sufficient facts to constitute a cause of action for fraud.[79]

Regarding the negligence cause of action, the Court of Appeal held out some hope for Lueras. The Court of Appeal held that a loan modification is a renegotiation of loan terms, which falls squarely within the scope of a lending institution's conventional role as a lender of money.[80] In its conventional role as a lender of money, a lender owes no duty of care to a borrower.[81] Accordingly, absent a contractual obligation to do so, a lender has no common law duty to offer, consider, or approve a loan modification or to offer alternatives to foreclosure to a borrower.[82] The Court of Appeal reaffirmed that due to the exhaustive nature of the nonjudicial foreclosure statutes, the courts have refused to read any additional common law requirements into the nonjudicial foreclosure process.[83] But, the Court of Appeal in this case did hold that a lender owes a duty to a borrower to not make material representations about the status of a loan modification application or about the date, time, or status of a foreclosure sale.[84] Accordingly, the Court of Appeal granted Lueras leave to amend the negligence cause of action to state a cause of action for negligent misrepresentation regarding the status of the loan modification application and the status of the foreclosure sale.[85] Though, a strong dissent by Justice Thompson undercuts the strength of the *Lueras* decision.[86]

The case that holds out the most hope to homeowners for judicial relief is *Bushell v. JPMorgan Chase Bank N.A.*,[87] discussed next.

IV. CONTRACT INTERPRETATION AND HAMP

A. *Bushell*: Hope for Homeowners

In May 2004, Richard and Susan Bushell (the "Bushells") obtained a loan to purchase a home in Roseville.[88] By May 2009, the home loan was in default and the lender, JPMorgan Chase Bank ("Chase"), had sent the Bushells a trial loan modification plan.[89] The Bushells commenced making trial modification payments in June 2009.[90] In November 2010, Chase requested updated information from the Bushells.[91] The Bushells provided the requested information on December 3, 2010.[92] Chase caused a notice of trustee's sale to be recorded on or about January 27, 2011.[93] The Bushells then filed suit for breach of contract, promissory estoppel, and fraud.[94] The trial judge dismissed the Bushells' complaint for failure to state facts constituting a cause of action.[95] The trial judge ruled that the trial modification plan was an agreement to agree, which is unenforceable as a matter of law.[96]

The Court of Appeal reversed the judgment of dismissal of the breach of contract, promissory estoppel, and fraud causes of action.[97] Regarding the breach of contract cause of action, the Court of Appeal held that HAMP mandates that a lender must offer a permanent loan modification under certain conditions and that the "Must Offer" mandate is part of the trial loan modification plan. Accordingly, the HAMP mandate provides the missing term to create an enforceable contract.[98] Based upon that liberal reading of the legal effect of California contract law, the Court of Appeal had no problem also concluding that the Bushells had alleged sufficient facts to constitute a cause of action for promissory estoppel and fraud.[99]

The strength of the *Bushell* case is undercut by the settlement of the case by the parties before the decision was rendered.[100] Nonetheless, a homeowner seeking enforcement of a loan modification should be well versed in HAMP.

B. Summary of the Home Affordable Modification Program

In 2008, Congress enacted the Troubled Asset Relief Program ("TARP") which was designed to inject capital into troubled banks and to develop a plan to reduce foreclosures.[101] The plan that was developed was introduced in February 2009 and became known as HAMP. As part of the plan, the Secretary of the Treasury set aside up to $50 billion for modifications and entered into Servicer Participation Agreements through which the lenders agreed to modify eligible loans in exchange for $1,000.[102] The $1,000 payment from the government to the lender was intended to be an incentive payment to induce lenders to modify loans to avoid foreclosure.[103]

1. *Eligibility Requirements*

In order for the loan to be eligible, it had to be secured by the borrower's primary residence, the regular monthly payment had to be above thirty-one percent of the borrower's gross monthly income, and, for one-unit residences, the principal balance had to be no greater than $729,750.[104] If the loan met these criteria, then the lender would reduce the monthly payment to thirty-one percent of the borrower's income and apply a Net Present Value ("NPV") to determine whether it was more profitable to modify the loan or foreclose.[105] If the lender determined that the NPV was higher for the loan modification, then "the servicer MUST offer the modification."[106]

2. *Trial Period Plans*

Once the lender determined that the homeowner was eligible under HAMP, the lender was supposed to offer a Trial Period Plan ("TPP"). During the TPP, the borrower would make the modified payment amounts and provide additional documentation to confirm that the borrower was in fact qualified for a loan modification under HAMP.[107] If the borrower submitted the required documents and made all of the payments under the TPP, the lender was required to offer a permanent loan modification.[108] The reason the lender was required to offer a permanent loan modification was because a lender who "received public tax dollars under [TARP] . . . agreed to offer TPP's and loan modification under HAMP according to [regulations] . . . issued by the Department of the Treasury."[109] If the borrower did not qualify for the loan modification, then the lender was required to inform the borrower of the ineligibility and to explore other alternatives to foreclosure.[110]

In reality, although HAMP required a lender to offer a permanent loan modification, few lenders actually offered one even if the borrower complied with the requirements. Instead, when the lenders offered a TPP, many of the lenders included language in the TPP that was designed to make the offer of a permanent loan modification solely in the discretion of the lender.[111] After a certain period of time, the lenders would eventually foreclose after denying the loan modification.

C. Federal Courts and Contract Interpretation

The Ninth Circuit Court of Appeals decision in *Corvello v. Wells Fargo Bank* provides some further hope for homeowners by requiring lenders, under appropriate circumstances, to offer a HAMP loan modification to their borrowers.[112] It is consistent with, and provides strong support for, the holding in *Bushell*, discussed in Section IV.A above.[113]

In the first of the two cases underlying this consolidated appeal, Phillip Corvello ("Corvello") alleged that he entered into a written TPP with Wells Fargo, that he fully complied with the TPP by submitting all required documentation and timely making all required payments, and that Wells Fargo neither offered him a permanent loan modification nor notified him that he did not qualify for the modification.[114] As a consequence, Corvello sought, in addition to damages, the permanent loan modification which he claimed he was contractually obligated to receive from Wells Fargo.[115]

In the second consolidated case, Karen and Jeffrey Lucia ("Lucia") alleged that they telephonically entered into a TPP with Wells Fargo, that they too fully complied with the TPP by submitting all required documentation and making all required payments, and that Wells Fargo neither offered them a permanent loan modification nor notified them that they did not qualify for the modification.[116] Adding insult to injury, Wells Fargo foreclosed upon and resold their home.[117] Lucia sought rescission of the foreclosure and subsequent sale, damages, and the permanent loan modification to which they are entitled.[118]

The district court dismissed both cases, concluding that the language of the TPP was insufficient to support a contract requiring a permanent modification.[119] The district court relied upon language in the TPP to the effect that the loan would not be modified "unless and until" the borrower received a copy of a fully executed modification agreement.[120] The district court ruled that because Wells Fargo did not send a signed modification agreement, it was not contractually required to offer a permanent modification to either Corvello or Lucia.[121] Based thereon, the district court dismissed not only the causes of action for breach of contract, but also all other causes of action against Wells Fargo, as all claims were dependent upon an enforceable promise by Wells Fargo to offer a permanent modification.[122]

On appeal, the Ninth Circuit framed the issue before it as follows: "[W]hether the bank was contractually obligated under the terms of the TPP to offer a permanent modification to borrowers who complied with the TPP by submitting accurate documentation and making trial payments."[123] The court looked to *Wigod v. Wells Fargo Bank, N.A.*, which it described as the "leading case" on the issue which had held that banks were affirmatively required to offer permanent modifications to borrowers who completed their TPP obligations unless the banks timely notified those borrowers that they did not qualify for a permanent HAMP modification.[124] The Seventh Circuit in *Wigod* refused to allow Wells Fargo to avoid its obligations to otherwise qualified borrowers by simply choosing not to send back a signed modification agreement.[125] Relying on *Wigod*, the Ninth Circuit rejected the trial court's view of the effect of the TPP's "unless and until" language. The Ninth Circuit stated: "Paragraph 2G [the "unless and until" provision] cannot convert a purported agreement setting forth clear obligations into a decision left to the unfettered discretion of the loan servicer."[126]

Noting that the *Wigod* case dealt with the application of Illinois contract law, the Ninth Circuit concluded that there was no material difference under California law.[127] It cited to the California Court of Appeal case *West v. JPMorgan Chase Bank, N.A.*,[128] which expressly adopted the reasoning of *Wigod* and held that under California law, banks are required to offer permanent HAMP modifications if the borrower complies with the TPP.[129]

Of special interest is the Ninth Circuit's rapid dismissal of Wells Fargo's contention that the Lucia claim for breach of contract could not survive the statute of frauds.[130] Wells Fargo had asserted that the Lucia telephonic contract was an oral agreement to modify a mortgage and thus defeated by the statute of frauds.[131] The Ninth Circuit pointed out that Lucia had alleged full performance of their promises under the contract and thus held that Wells Fargo's remaining promises under the contract could be enforced.[132] This approach to the statute of frauds issue may allow borrowers to effectively plead their way around the holding in *Rossberg v. Bank of America*, [133] discussed in section II.A above. Doing so, however, will likely require pleading performance of non-monetary obligations in addition to payment obligations, as the payment of money alone has been held insufficient part performance to take a contract out of the statute of frauds.[134] Although not specifically addressed by the Ninth Circuit in *Corvello*, Lucia appears to have effectively pled performance of its non-monetary obligations by asserting submission of the documents requested by Wells Fargo.[135]

V. CONCLUSION

There is no majority opinion that a borrower has a private contractual right to sue a lender upon allegations of noncompliance with HAMP rules or regulations.[136] Nonetheless, California courts have used rules of contract interpretation to include HAMP's "must offer" directive in loan modification agreements.[137] As one court explained, this interpretation correctly "reflects" the conditional promise of a loan modification agreement.[138] Both the federal cases and the California cases discussed in this article have rethought established contract law rules regarding the interpretation of contracts and the use of extrinsic evidence in interpreting contracts. Specifically, both the federal and California cases have expanded the concept of extrinsic evidence to include Treasury regulations issued pursuant to HAMP.

However, the California cases using the rules of contract interpretation to implement HAMP directives are based upon decisions reversing the sustaining of a demurrer without leave to amend. As every experienced trial attorney knows, a well pled complaint does not ensure a plaintiff's verdict at trial. Nor do the recent cases discussed in this article create a lasting legal legacy in loan modification law in California. One can only hope that a borrower's case for breach of contract arising from a loan modification agreement will result in a plaintiff's jury verdict and a published opinion affirming that judgment on appeal. It will require additional case law in California to further implement the promise made by President Obama in February of 2009 to help millions of homeowners modify the terms of their mortgages to avoid foreclosure. The cases discussed in this article provide specific examples of how the lack of a federal private right of action allowing a borrower to directly enforce the promise of a loan modification frustrated the borrower's attempts to avoid foreclosure. On the other hand, the cases discussed in this article hold out hope that new interpretations of foreclosure agreements and loan modification agreements based upon the use of extrinsic evidence in the form of Treasury regulations issued pursuant to HAMP will provide meaningful contract rights entitling California homeowners to permanent modifications of their home loans.

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ENDNOTES

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