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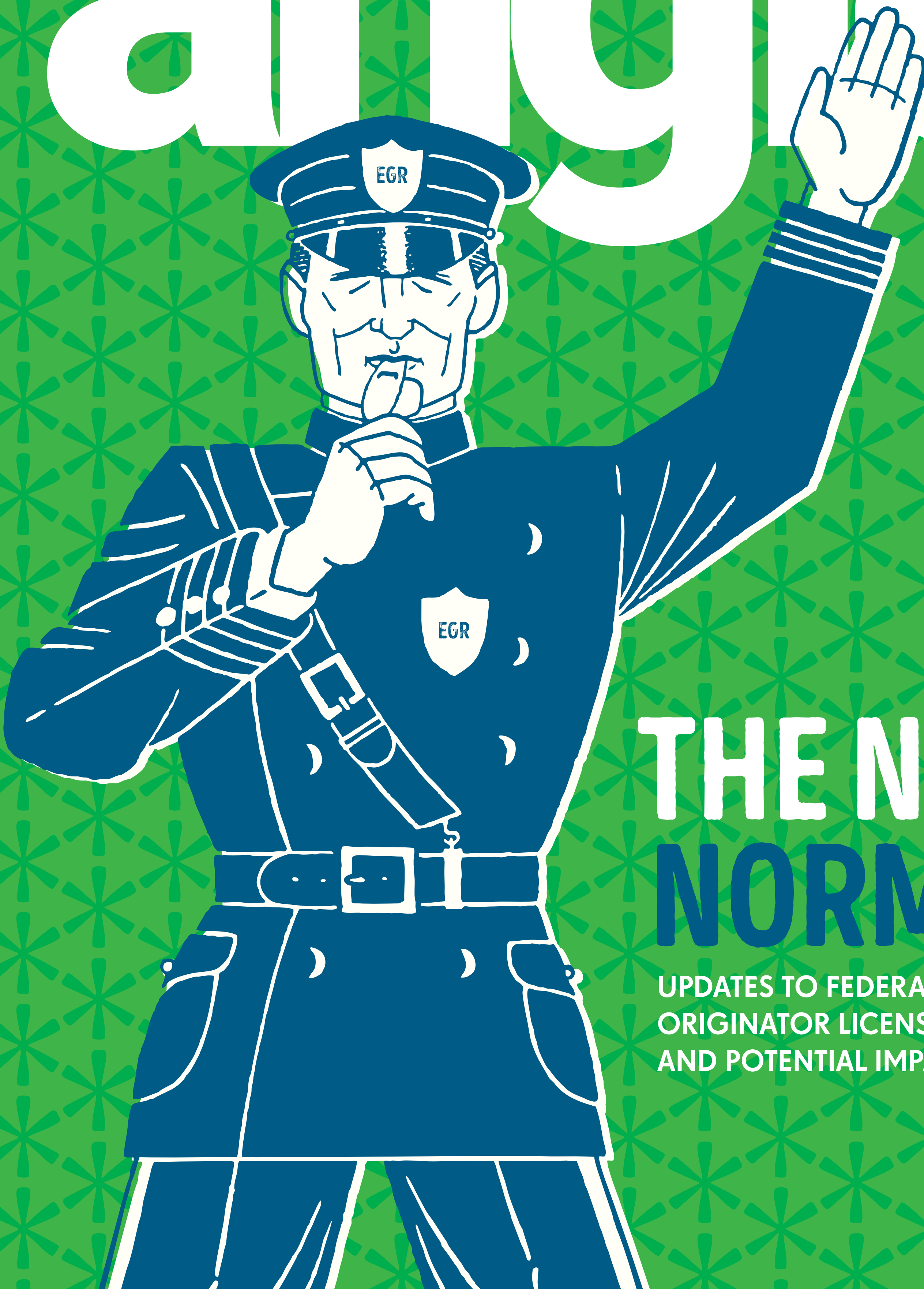


# THE NEW NORMAL

## UPDATES TO FEDERAL LOAN ORIGINATOR LICENSING LAW AND POTENTIAL IMPACTS

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# Letter from the Editor

THE ALFN Angle brings you the latest up-to-date information on legal issues that may have far reaching impacts in our industry. With this resource in hand, you can rest assured that ALFN continues to strive for excellence in education and providing our members the information they require to make informed business decisions.

The cover feature of this issue brings us an important regulatory update on The Economic Growth, Regulatory Relief, and Consumer Protection Act, S. 2155. We will review this federal originator licensing law and its potential impacts to the mortgage industry. Don't miss our State Snapshot contributions to wrap up this ANGLE issue, where we will address some important state specific updates in Illinois, Maryland, Massachusetts, Minnesota, New Hampshire, New York, Ohio, Rhode Island, Virginia & Washington.

Next up on the educational event agenda is ANSWERS, ALFN's 17th Annual Conference. We have yet another top-notch event lined up for you this July 21-24 at the picturesque Hyatt Regency Lake Tahoe Resort in Incline Village, NV. You can't afford to miss this one, so register now at ALFNANSWERS.org as our room block is filling fast. Our 2019 educational programming will conclude with Foreclosure Intersect on November 13 at the new Westin Irving Convention Center. This event plays host to several educational sessions as we diver deeper into the latest legal issues and complexities of residential mortgage foreclosures.

I look forward to seeing each of you at ANSWERS this July. Please reach out to let me know what the ALFN can do to assist you, or to discuss ways to get more involved.

**MATT BARTEL**
President & CEO
American Legal & Financial Network (ALFN)

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# THE NEW NORMAL

## UPDATES TO FEDERAL LOAN ORIGINATOR LICENSING LAW AND POTENTIAL IMPACTS

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EGR

LOAN PRODUCTS Can include mortgage loans, auto finance loans, unsecured personal loans, and other loan types.[1] Loan activity may be described as origination (brokering), lending (funding), and servicing.[2] These activities occur across multiple entities or occur in-house—within one entity. Banks and other x institutions fund loans through deposits. Traditionally, depository institutions serviced their own loans. In contrast, mortgage companies and/or other non-depository institutions funded loans through investment and may have performed only one such loan activity.[3] While banks and depository institutions may offer a variety of loan products, mortgage companies' activities are typically limited to mortgage loan products only.[4] Competition continues to grow between non-depository mortgage companies ("NDMCs") and depository institutions ("DIs"), with NDMCs surpassing DIs in mortgage loan origination activity post-Financial Crisis.[5]

The Economic Growth, Regulatory Relief, and Consumer Protection Act, S. 2155, ("EGR") becomes effective on November 24, 2019. Under this federal law, states must implement transitional licensing for mortgage loan originators ("MLOs") by November 24, 2019. States regulate and license NDMC MLOs. A NDMC MLO must obtain a state license prior to originating mortgage loans. A transitional license is a temporary license that will permit MLOs transitioning from DIs to NDMCs to originate mortgage loans in a state prior to the state regulator approving the MLO's license application.[6] EGR does not permit all MLOs to leave a DI and immediately begin originating for an NDMC during the temporary period. Rather, the temporary authority to originate is only granted to an MLO who was registered in the Nationwide Mortgage Licensing System and Registry ("NMLSR") as an MLO during the one-year period preceding the state license application. EGR amends the Secure and Fair Enforcement of Mortgage Licensing Act, including Section 106 Eliminating Barriers to Jobs for Loan Originators. Sen. Mike Crapo (R-ID), Chair of the Senate Banking Committee, introduced EGR, and the President signed the law on May 24, 2018.

EGR may impact the mortgage industry in three interdependent ways. First, EGR may reduce regulatory barriers restricting the job opportunities available to MLOs. With fewer job mobility restrictions, more MLOs may transition from a DI to a NDMC. Second, with more MLOs potentially working for NDMCs, the rate of defaulted mortgage loans may be impacted. Finally, if the rate of default is impacted by MLOs working for NDMCs, servicing activities may be impacted.

[1] See Morgan Clemons, Introduction to Financial Compliance: Consumer Financial Services Regulation 7, 9-11 (2018).

[2] See id. at 11-14.

[3] See id. at 5-7

[4] See id. at 10..

[5] See Michele Lerner, The Mortgage Market is Now Dominated by Non-Bank Lenders, Wash. Post, Feb. 23, 2017.

[6] Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115–174, sec. 106, §1518(b)(E) (2018).[7] S Economic Growth, Regulatory

## ORIGINATION JOBS

Prior to EGR, MLO job mobility was somewhat restricted. MLOs employed by DIs were merely "registered" in the NMLSR. However, state and federal law required MLOs employed by NDMCs to meet initial and ongoing licensing requirements submitted through the NMLSR, including passing an examination and taking continuing education courses. These requirements made it more challenging for MLOs to compete for positions within the industry without regard to entity type (NDMC vs. DI employers). An MLO seeking to leave a DI to move to a NDMC was not permitted to continue loan origination activities until the state approved the MLO's license application. As a result, the MLO may have been limited in income-earning potential and the ability to perform the same activities that the MLO, theoretically, already had experience performing under the supervision of a DI employer. This barrier, arguably, prevented talented MLOs from making the shift from DIs to NDMCs. The inability to originate while awaiting license application approval diminished an MLO's likelihood of being hired by NDMCs.

EGR permits "temporary authority to originate loans for MLOs moving from a depository institution to a non-depository institution."[7] When EGR becomes effective, MLOs transitioning from DIs to NDMCs can continue to originate mortgage loans while awaiting the approval of the state license. The ability to work for a mortgage lender rather than a bank permits the MLO to compete for more employment positions and to gain expertise with an employer that only focuses on one credit product: mortgages. [8]

EGR may impact the mortgage industry in three interdependent ways.

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[7] Relief, and Consumer Protection Act, Pub. L. No. 115–174, sec. 106, §1518(b) (2018).

[8] See Mat Ishbia, Nonbank mortgage lenders still misunderstood in mainstream media, Housingwire.com (Mar. 14, 2018) https://www.housingwire.com/blogs/1-rewired/post/42749-nonbank-mortgage-lenders-still-misunderstood-in-mainstream-media.

**It is unlikely that the, arguable, limited experience of DI MLOs transitioning to NDMCs will be impactful enough to increase defaults.**

## DEFAULTED LOANS

A DI MLO's ability to transition more easily to an NDMC could potentially impact mortgage defaults. Mortgage defaults could increase. First, NDMCs continue to increase their share of the mortgage origination market following the financial crisis. [9] Because underwriting criteria may be more flexible with NDMCs,[10] mortgages serviced by nonbanks are more likely to go into default.[11] More NDMC MLOs may increase mortgage defaults because arguably, there simply will be more MLOs originating more non-standard mortgage products based on more flexible underwriting criteria. With potentially more MLOs employed by NDMCs, the increased market share trend will likely continue based simply on more human capital—more people to originate mortgages for the NDMCs. Second, there is an argument that more NDMC-employed MLOs may increase mortgage defaults because the MLOs who have only worked for DIs may, arguably, lack experience in originating the type of atypical, flexible mortgage loan products that may be more prevalent at NDMCs.

It is unlikely that the arguably, limited experience of DI MLOs transitioning to NDMCs will be impactful enough to increase defaults. While a former DI MLO may have to adjust to a wider variety of customers and mortgage loan products, a former DI MLO will not be wholly inexperienced in mortgage products and services; to be eligible for transitional licensing, an MLO has to have been registered as an MLO in the NMLSR with a DI in the preceding year.[12] In any case, it is not likely that a NDMC would seek to hire an untrained MLO who does not have a history of registration with a DI or who otherwise lacks loan origination experience. In addition, it is not definitive that an increase in

[9] See Lerner, supra note 5.

[10] See You Suk Kim et al., Liquidity Crises in the Mortgage Market, Brookings Papers on Economic Activity, Spring 2018, at 351. Nonbank lenders originate mortgages for borrowers with lower incomes and lower credit scores.

[11] See id. at 349.

[12] Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115–174, sec. 106, §1518(b)(E) (2018).

[13] See Steven T. Mnuchin & Craig S. Phillips, U.S. Department of the Treasury Report to President Donald J. Trump, A Financial System that Creates Economic Opportunities: Nonbank Financials, Fintech, & Innovation (July 2018), at 88, available at https://home.treasury.gov/sites/default/files/2018-07/A-Financial-System-that-Creates-Economic-Opportunities---Nonbank-Financi....pdf.

defaults may harm originating NDMCs. NDMCs are more likely than banks to sell the loan asset but retain servicing.[13] While an increase in defaults may not directly harm the NDMC's origination business, it may impact the NDMC's servicing activity, discussed infra. Specifically, "servicers can incur large costs in servicing delinquent loans."[14]

The alternative argument is that default rates may actually decrease with more NDMC MLOs and, consequently, more NDMC loans.[15] The potential default decrease would lead to fewer foreclosures.[16] More NDMC MLOs, by volume, may decrease defaults because mortgage lenders, in contrast to banks, have been championed for bringing innovation, efficiency, and customer service considerations to the mortgage lending process. This efficiency and focus on innovation in origination may yield fewer risky loans that will default, and, as a result, may lead to less need for specialized legal and foreclosure services.

## SERVICING ACTIVITY

The impact to loan defaults as well as more NDMC loan originators, by volume, can impact servicing activity. As discussed, if loan default activity increases, the increase may increase the cost of servicing. Alternatively, if loan defaults decrease due to origination innovation, there will be a reduction in foreclosures. Finally, in the 2018 J.D. Primary Mortgage Servicer Satisfaction Study press release, it was stated that "in a highly competitive origination market in which small differences can have a big effect, the servicing experience can't be ignored. Among servicers that achieve 900+ in overall satisfaction, 65% of customers say they 'definitely will' choose the same company for their next home purchase and 84% say they 'definitely will' recommend the servicer." Therefore, what happens in origination does not stay in origination, and what happens in servicing does not stay in servicing. In fact, some have argued that this increased competition in the workforce can lead to more NDMC MLO hiring and such MLOs, having to comply with state-licensing requirements would be better-qualified with a more complete compliance understanding. A better-qualified MLO could lead not only to more significant consumer satisfaction during the origination process, but also lead to a lower likelihood of loan default and resulting greater consumer satisfaction when servicing the loan for the third party investor.

It is difficult to predict how mortgage origination transitional licensing may impact servicing and the default market, if at all. The anticipated benefit of EGR is that the law will allow for increased employment mobility among mortgage loan originators in the industry. The increase in employment competition is, in turn, supposed to lead to more access to qualified MLOs who are more likely to be compliant with lending laws. However, such NDMCs have been heralded for increasing access to consumer credit in the form of nontraditional mortgage products, while also being criticized for offering higher-risk nontraditional mortgage products that may end up in default. State compliance, mortgage product type, as well as licensing, training, and transition period of the MLO must be balanced with the increasing domination of NDMCs in the mortgage originations market. a

[14] See Kim, supra note 10 at 376.

[15] See Can Online Lending Decrease Risk?, DS News, https://dsnews.com/daily-dose/02-23-2018/can-online-lending-decrease-risk, (Feb. 23, 2018) ("Default rates on fintech mortgages [for FHA mortgages] were about 25 percent lower than those for traditional lenders, indicating that fintech technologies might be helping to attract and screen for less risky borrowers.").

[16] See id.

[17] See Kim, supra note 10 at 376.

[18] Press Release, J.D. Power, Mortgage Servicer Satisfaction Remains Unchanged Despite Mortgage Companies' Investment in Technology, J.D. Power Finds (July 26, 2018) https://www.jdpower.com/business/press-releases/2018-primary-mortgage-servicer-satisfaction-study.

[19] See SAFE Act: Implementation of MLO Transitional Authority, Mortgage Bankers Ass'n, https://www.mba.org/issues/residential-issues/safe-act-revisions-transitional-authority.

[20] See Mortgage Bankers Ass'n, supra note 8.

[21] In fact, the "Eliminating Barriers to Jobs for Loan Originators" section of the Act is, perhaps intentionally, included in Title I entitled "Improving Consumer Access to Mortgage Credit." Economic Growth, Regulatory Relief, and Consumer Protection Act, Pub. L. No. 115–174, sec. 106, §1518 (2018).

**STATE SNAPSHOT**

# ILLINOIS

# Illinois Appellate Court Finds General Denial of the Performance of a Condition Precedent as an Admission of that Performance

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**THE APPELLATE Court of Illinois has offered a bit of guidance for practitioners in prosecuting mortgage foreclosure actions. The Court in *Bank of N.Y. Mellon v Wojcik*, 2019 IL App (1st) 180845, was presented with the issue of whether the trial court erred in denying the defendants' cross-motion for summary judgment in a foreclosure action concerning defendants condominium unit. In answering the Complaint to Foreclose, defendants answer denied the deemed allegation found in 735 ILCS 5/15-1504(c)(9) that any and all notices of default or election to declare the indebtedness due and payable or other notices required to be given have been properly given. *Bank of New York Mellon v. Wojcik*, 2019 IL App (1st) 180845, ¶ 7. In response, the Bank of New York argued that defendants had waived their argument because there were no specific facts raised to show how the condition precedent had not been met. In essence, Bank of New York utilized the requirements of Illinois Supreme Court Rule 133(c). As the Court in *Wojcik* found, Rule 133(c) requires, when pleading a condition precedent, e.g., sending of a notice of default, that it is sufficient to allege that the party completed the conditions on their part and that if the allegation is denied, specific facts must be alleged showing where there was a failure to perform. *Bank of New York Mellon v. Wojcik*, 2019 IL App (1st) 180845, ¶ 20.**

Further, relying on other Illinois decisions, the *Wojcik* Court stated, "[A] general denial to an allegation of the performance of a condition precedent in a contract is treated as an admission of that performance." *Bank of New York Mellon v. Wojcik*, 2019 IL App (1st) 180845, ¶ 21. Accordingly, the Court refused to allow contradiction at the summary judgment stage and instead found that the defendants' judicial admission in their answer as to the deemed allegations of the Complaint to Foreclose did not lead to an issue of fact thereby affirming the decision of the trial court denying defendants' cross-motion for summary judgment.

This opinion sent a strong lesson on Illinois Supreme Court Rule 133(c): "As our supreme court has recognized: "The rules of court we have promulgated


are not aspirational. They are not suggestions. They have the force of law, and the presumption must be that they will be obeyed and enforced as written." *Bank of New York Mellon v. Wojcik*, 2019 IL App (1st) 180845, ¶ 24 citing *Bright v. Dicke*, 166 Ill. 2d 204, 210, 652 N.E.2d 275, 209 Ill. Dec. 735 (1995).

In practice, it has been common for Defendants' answers to Complaints to Foreclose to include general denials of deemed allegations, including the deemed allegation that required notices were sent. Often, when a party denies a deemed allegation, Illinois Courts have required Plaintiffs, at the summary judgment stage, to establish that notices were sent, which makes this opinion particularly beneficial to Plaintiffs in foreclosure matters. Adopting the approach in Wojcik in Illinois will improve judicial economy and ensure that cases are decided upon the merits rather than simply making a Plaintiff jump through hoops after already establishing a prima facie case for foreclosure.

STATE SNAPSHOT

# MARYLAND

# STATE SNAPSHOT

# Maryland Senate Bill 485 Attempts to Reverse Blackstone v. Sharma, 233 Md. App. 58, 161 A.3d 718 (2017) Decision

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ON FEBRUARY 4, 2019 a bill was introduced in the Maryland legislature, with the stated intent of abrogating the holding of the Court of Appeals of Maryland in Blackstone v. Sharma, 27 461 Md. 87, 191 A.3d 1188 (2018), and reinstating the decision of the Court of Special Appeals of Maryland in Blackstone v. Sharma, 233 Md. App. 58, 161 A.3d 718 (2017). In short, that decision stated that, notwithstanding any separate licensing by the loan servicer, if different, the owner of the loan, if not otherwise exempt, must be licensed under the Maryland Collection Agency License Act (MCALA) in order to commence a foreclosure on real property in this state securing a "consumer loan," if the loan was in default at the time acquired by the current owner. Banks, credit unions, saving & loan associations, government-sponsored enterprises and entities that are otherwise licensed under the Maryland Mortgage Lender Law ("MMLL"), are exempt from the requirements of the proposed law. However, the decision in Blackstone v. Sharma, 233 Md. App. 58, 161 A.3d 718 (2017) specifically held that foreign statutory trusts were not exempt from the requirements of the law.

The introduction of this Bill left many investors and attorneys concerned. After waiting over a year for the Court of Appeals decision in Blackstone v. Sharma, 233 Md. App. 58, 161 A.3d 718 (2017), investors were scrambling to determine if becoming licensed was the best option, as another hold up would cause major timeline delays.

On March 12, 2019, the first hearing was held in front of the Senate Finance Committee, at which time numerous lobbyists and attorneys testified in favor of upholding the Court of Appeals decision. On March 29, 2019, the Senate Finance Committee returned an unfavorable report on the Bill.

Although this Bill did not make it out of Senate, it should be noted that it was sponsored by nearly half the members of the Maryland Senate, and had the support of the Office of the Attorney General.

**Although this Bill did not make it out of Senate, it should be noted that it was sponsored by nearly half the members of the Maryland Senate, and had the support of the Office of the Attorney General.**

With that being said, this licensing issue could remain a hot button topic for future legislative sessions. Although the future of any required licensing is uncertain, investors can rest easy for at least another year.

## STATE SNAPSHOT

# MASSACHUSETTS

# The Foreclosure Process Becomes Even More DEMAND-ing for Lenders in Massachusetts:

## *Implications of Thompson v. JPMorgan Chase Bank, N.A.*

BY JULIE A. RANIERI, ESQ.
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LENDERS, SERVICERS and their counsel in Massachusetts encountered yet another obstacle to navigate in the foreclosure process with the First Circuit Court of Appeals' decision in Thompson v. JPMorgan Chase Bank, N.A., Case No. 18-1559 (1st Cir. 2019) on February 8, 2019. The Massachusetts Supreme Judicial Court, the state's highest court, has historically been the bearer of bad news to the lending industry; this time, however, it is a three-judge panel of the federal First Circuit Court of Appeals throwing the latest curveball with potentially widespread implications for foreclosing mortgagees.

In Thompson, the First Circuit invalidated a foreclosure sale finding that language in the pre-foreclosure demand letter, known as the Notice of Right to Cure Mortgage Default ("Right to Cure Notice") , and sent pursuant to M.G.L. c. 244 §35A, conflicted with Paragraph 19 of the Uniform Fannie Mae/ Freddie Mac single-family mortgage instrument ("Uniform Instrument"). The contents of the Right to Cure Notice, aside from optional, additional disclosures, is prescribed by state regulation. This required content includes language informing the mortgagor that he could "still avoid foreclosure by paying the total past-due amount before a foreclosure sale takes place." The Thompson court found the foregoing language to be at odds with language appearing in Paragraph 19 of the Uniform Instrument requiring that reinstatement occur, if at all, at least five (5) days before the foreclosure sale; this despite the Court's recognition that the Right to Cure Notice contained all of the disclosures required by Paragraph 22 of the Uniform Instrument.[5]

Massachusetts law requires that notice to the mortgagor "be accurate and not deceptive." *Id*, at 3. In this case, the Court reasoned that the borrowers could be misled into thinking they could wait until a few days before the foreclosure sale to tender reinstatement funds based on the language of the Right to Cure Notice, when in fact Paragraph 19 imposed a time limit on the borrower's right to do so. The Thompson Court concluded that the language in the Right to Cure Notice concerning the time the borrowers had to reinstate and omitting the five-day qualifier rendered the Notice "potentially deceptive." *Id*, at 4.

In the weeks following the decision several servicing clients have questioned whether the Thompson holding applies to them because their actual practice is to accept reinstatement until the moment of sale. The Thompson Court, however, made it clear that whether the Right to Cure Notice was potentially deceptive or not was to be determined solely on the basis of the content of the notice itself in

conjunction with the terms of the mortgage instrument. Whether a given borrower actually had sufficient funds to reinstate or actually made any attempt to tender reinstatement funds was deemed irrelevant. For the same reason, whether a given servicer's practice is or would be to accept such funds even inside of five days of the foreclosure sale is irrelevant. Whether the Thompsons were actually prejudiced by the Right to Cure Notice was unimportant to the Court; rather, it referenced current case law and found that mortgagors do not need to "prove that the inaccuracy or deception caused harm . . . ." *Id*, at 3.

From the lender perspective, the decision was wrongly decided. The specific language in the Right to Cure Notice that the Court found to conflict with Paragraph 19 of the mortgage, and therefore "potentially deceptive" to the borrowers, was not drafted by Chase; rather, it comes directly from the aforementioned state regulation (209 CMR 56.04). This key fact was not discussed in the decision. The court incorrectly stated that ". . . the bank is the one writing the notice and has ample opportunity and expertise to make it entirely accurate." *Id*, at 3. Based on this statement, the Court could not have been aware that (a) the allegedly misleading language is directly from a Division of Banks-mandated form, (b) Chase had no control over the content of the Notice, and (c) under 209 CMR 56.03 the Right to Cure Notice "must strictly conform" to the format set forth in the regulation. Further, if a lender deviates from the strict compliance form, it could similarly be held accountable for failing to adhere to the statute and regulation which require use of the form letter and the language therein. This decision, therefore, creates a dilemma for lenders.

In addition, the Court did not consider that Paragraph 16 of the Uniform Instrument


provides, in relevant part, that "[a]ll rights and obligations contained in [the] Security Instrument are subject to any requirements and limitations of Applicable Law." Based on the plain reading of this paragraph, applicable law prevails if there is a conflict between the terms of the mortgage and applicable law. "Applicable law" in the form of M.G.L. c. 244, § 35A and the regulation (209 C.M.R. 56.04) adopted pursuant to legislative authority contained in §35A, requires use of a strict-compliance form letter that expands the right to reinstate through the time of sale. There is indeed no conflict between the mortgage and the Right to Cure Notice because the mortgage itself states that applicable law prevails if a conflict arises.

This case has significant implications for both pending and completed Massachusetts foreclosure sales as the decision does not appear to be limited to prospective application. Of particular concern are the insurability of the purchaser's title at foreclosure or REO disposition and the potential for completed sales to be undone.

As of the writing of this article, Chase successfully moved the First Circuit for an extension of time to petition for rehearing before the panel and/or rehearing en banc. That extended deadline expires on March 25, 2019. It

[1] Marcus Pratt, Esq., Korde & Associates, P.C. assisted in the writing of this article.

[2] See U.S. Bank N.A, Trustee v. Ibanez, 458 Mass. 637 (2011) (a foreclosing entity must be the assignee of record at the time of foreclosure); Bevilacqua v. Rodriguez, 460 Mass. 762 (2011) (applying Ibanez to third-party buyers); Eaton v. Federal National Mortgage Association, 462 Mass. 569 (2012) (a mortgagee must either hold the note or be the authorized agent of the note holder in order to validly foreclose); U.S. Bank N.A, Trustee v. Schumacher, 467 Mass. 421 (2014) (the statutory demand process is not part of the mortgage foreclosure process, and compliance therewith cannot be challenged in a post-foreclosure summary process action); Pinti v. Emigrant Mortg. Co., Inc., 472 Mass. 226 (2015) (a mortgagee was required to comply strictly with the terms of a mortgage relative to notice to a mortgagor of default and the right to cure).

[3] The Notice of Right Cure Mortgage Default is a statutorily required demand letter providing mortgagors with a 90-day cure period.

[4] See 209 C.M.R. §56.04.

[5] Informing the mortgagor of the default, the action required to cure the default, the date by which the default must be cured, the right to reinstate after acceleration and the right to bring a court action to determine the default or any other defense to acceleration and sale.

is anticipated that local industry organizations will file amicus briefs to support the lender position and emphasize the practical effects of the decision.

While the industry awaits rehearing or a revised order, how do lenders address this latest issue in Massachusetts? There have been ongoing discussions between default firms, insurers and lenders/servicers regarding remediation and how best to proceed with foreclosures given this decision. Remediation options evolved, almost daily, based on insurer feedback. One remediation option presented and approved by some insurers is for a confirmation notice to be sent to all signatories on the note and mortgage at least thirty days before a foreclosure sale. The notice would advise borrowers that, notwithstanding any provisions in the mortgage to the contrary, they have until the time of sale to reinstate. Currently, this is the least disruptive course of action to keep foreclosures moving and avoid delay. This, however, does not address foreclosure sales consummated and of record before Thompson, including sales to bona fide third-party buyers. Currently, there is little insurer guidance and it remains to be seen if the validity of these sales will be challenged.

Only time will tell how Thompson may continue to impact the foreclosure landscape in Massachusetts. Until the case is further adjudicated, lenders and their counsel will need to decide how best to proceed with pending default portfolios.

STATE SNAPSHOT

# MINNESOTA

# FCRA—Federal Court Clarifies Mortgage Servicer Responsibilities After Loan Transfers

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**In Hrebal v. Seterus, Inc. (D. Minn., 2019), a Federal District Court situated in the 8th Circuit issued an Order which presents a cautionary warning to loan servicers. The case illustrates the potential perils when servicing loans following a service transfer, and specifically in reporting delinquencies under the Fair Credit Reporting Act (FCRA).**

In October 2007, Minnesota resident Charles Hrebal entered into a mortgage with the originating lender. When Hrebal ran into financial problems, he filed a Chapter 13 Bankruptcy listing four delinquent payments on his mortgage. For unknown reasons, the original lender filed a proof of claim (POC) for only two out of the four payments, and in response Hrebal filed an amended Plan reflecting that lender's lower claimed delinquency. The Plan was approved without objection. As in most such Plans in the district, the Trustee paid the lender past due amounts during the Plan period to pay the pre-petition arrears in full, and Hrebal directly maintained his ongoing payments post-petition. During the bankruptcy, the original lender recognized its POC filing error, but did not file an amended POC despite numerous notes found in its servicing records concerning the discrepancy.

The loan was subsequently service transferred to Seterus, Inc. Seterus continued to receive monthly post-petition payments during the bankruptcy proceedings, and did not raise the missing pre-petition payments issue during the pendency of the bankruptcy case. Also, when Hrebal called to inquire about his mortgage's status, Seterus appeared to inform him that he was "current on all payments." In 2015, Hrebal completed his Plan and was granted a discharge.

Unfortunately, the issue of the missed pre-petition payments reared its ugly head when Seterus raised for the first time that two payments were still due post-petition in response to a Trustee's Notice of Final Cure. Seterus' corporate witness later asserted that, even though Hrebal made every monthly payment after entering bankruptcy, the erroneous Proof of Claim filed by the original lender resulted in Hrebal "walking out of bankruptcy still two payments behind."

Thereafter, Hrebal discovered that Seterus reported the loan delinquent to the three major credit reporting agencies (CRAs) after Hrebal wrote Seterus and the CRAs to dispute the reported delinquency. According to the Court's findings, Seterus refused to notify the CRAs that the debt was disputed, never reviewed the prior servicer's notes, nor changed its internal records concerning the dates of the alleged delinquency.

Hrebal sued Seterus for violating the FCRA, claiming damages to reputation and emotional distress, and both parties moved for summary judgment. The parties primarily disputed whether Seterus provided "inaccurate" or "materially misleading" information to the CRAs when Seterus reported Hrebal as delinquent on his mortgage shortly after successfully completing

**It is important to note that this is just an Order denying Seterus summary judgment motion, not a final order assessing liability. It is unknown if the case will be settled, won at trial or appealed.**

a Chapter 13 bankruptcy plan, as well as whether Seterus's alleged FCRA violations were willful.

The first issue facing the Court was whether the two missing payments from the original lender's POC survived the bankruptcy discharge, in which case the credit reporting by Seterus of Hrebal being "two payments behind as he exited bankruptcy" might have been "technically accurate." However, the district court judge refrained from analyzing the bankruptcy issues due to split authority, and believed that the Court could resolve the FCRA claims without opining on that "complex" bankruptcy law question.

Turning to the FCRA claims, the Court recognized that the FCRA requires furnishers of credit information to provide accurate information to CRAs, and if informed by a CRA that a consumer is disputing any information appearing on their credit report, the furnisher must conduct a reasonable investigation of records to determine whether disputed information can be verified. See, 15 U.S.C. § 1681s. Courts across the country have generally held that "a fairly searching inquiry, or at least something more than a mere cursory review" is required under the FCRA for such an investigation to be reasonable. Also, multiple circuit courts have held that "even if credit information is technically correct, it may nonetheless be inaccurate if, through omission, it creates a materially misleading impression."

During an exhaustive factual review, the Court found a number of servicing errors starting with the initial, mistaken POC. These purported errors included servicing records Seterus never reviewed when responding to the CRAs which easily should have been found per the Court. This caused inadequate responses by Seterus resulting in possibly "misleading and inaccurate reporting" which triggered the right for the borrower to claim damages.

Citing the record, the Court noted: ". . . perhaps most importantly, [Seterus employees] could have marked Hrebal's delinquency as 'disputed', but never did….", noting testimony that it was a Seterus blanket policy to never do so which in the Court's opinion may have evidenced a "willful or reckless disregard for compliance with the FCRA."

The district court denied Seterus's request to be dismissed from the litigation and the judge set the matter for trial. The Court found a jury could reasonably find that Seterus breached its FCRA duties by simply reaffirming Hrebal's delinquency without any mention of a dispute. That response rendered Seterus's credit reporting inaccurate because, through omission, it created a materially misleading impression that Hrebal was more financially irresponsible than he actually was, according to the Court. The Court further explained that a reasonable juror might find Seterus's omission especially misleading because Hrebal had just successfully completed a long Chapter 13 bankruptcy plan, received a discharge, and had not missed a mortgage payment in over five years.

It is important to note that this is just an Order denying Seterus summary judgment motion, not a final order assessing liability. It is unknown if the case will be settled, won at trial or appealed. But it should be read as a cautionary lesson by noting that if the original lender had acted on the improper information it found on its POC; or if Seterus had read the prior servicing notes and records; or followed guidelines noting that the debt was disputed for purposes of credit reporting, then this case perhaps might never have been filed.

As an important practice pointer for mortgage servicers, it is always prudent to carefully review prior servicing notes when receiving loans, especially whenever a servicing dispute is raised, to ensure responses to inquiries and records are entirely accurate and appropriate.

STATE SNAPSHOT

# NEW HAMPSHIRE

# New Hampshire Bill Proposes Change in Foreclosure Process From Non-Judicial to Judicial

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**ON JANUARY 2, 2019, the New Hampshire House of Representatives Re-introduced "An Act relative to Foreclosure by Civil Action" under House Bill 270. Like the 2018 introduction (HB1682-FN) it has passed in the House and was referred to the Senate Commerce Committee (where the bill was killed last year). This bill provides that foreclosure of a mortgage would be by a civil action in the superior court in the county in which the mortgaged premises or any part of it is located. The bill would also repeal the provisions for non-judicial power of sale mortgages pursuant to RSA 479:25 and reenact it to require commencement of foreclosure by civil action.**

Specifically, the bill sets forth the process for a judicial foreclosure wherein all parties having an interest appearing of record at the registry of deeds up through the time of recording the complaint or clerk's certificate must be joined, except a party in interest having a superior priority to the foreclosing mortgage, whose interest will not be affected by the proceedings. Parties with a superior interest must be notified of the action by sending a copy of the complaint by certified mail. Parties without a recorded interest may intervene in the action for purposes being added as party in interest any time prior to the entry of judgment.

The action shall be commenced pursuant to superior court rules and the mortgagee shall, within 60 days of commencing the action, record a copy of the complaint or clerk's certificate in each registry of deeds where the mortgaged property lies. Furthermore, the mortgagee will have to certify and provide evidence that all steps mandated by law to provide notice to the mortgagor have been strictly performed. The complaint shall also contain a certification of proof of ownership of the mortgage note, as well as produce evidence of the mortgage note, mortgage and all assignments and endorsements of the mortgage note and mortgage.

Other requirements include that the complaint contain the street address of the mortgaged property; book and page number of the mortgage; state the existence of any public utility easements recorded after the mortgage but before the commencement of the action; state the amount due and what condition of the mortgage was broken, and by reason of such breach, demand a foreclosure and sale.

Within ten (10) days after filing of the complaint, the mortgagee shall provide a copy of the complaint or clerk's certificate as submitted to the court to the municipal tax assessor of the municipality in which the property is located, and if the property is manufactured housing as defined in RSA 674:31, to the owner of any land leased by the mortgagor.

A ninety (90) day right of redemption is also being proposed, wherein the property may be redeemed by the mortgagor, by the payment of all demands and the performance of all things secured by the mortgage and the payment of all damages and costs sustained and incurred by reason of the nonperformance of its condition, or by a legal tender thereof, within ninety (90) days after the court's order of foreclosure.

Most alarming is the clause that acceptance, before the expiration of the right of redemption and

## STATE SNAPSHOT

**The impact to servicers will be such that what was once a streamlined process, taking approximately 90-120 days, would be significantly extended to the same time frame that exists in other judicial states such as Maine, Vermont and Connecticut.**

after the commencement of foreclosure proceedings of anything of value to be applied on or to the mortgage indebtedness constitutes a waiver of the foreclosure unless an agreement to the contrary in writing is signed by the person from whom the payment is accepted or unless the bank returns the payment to the mortgagor within ten (10) days of receipt. The receipt of income from the mortgaged premises by the mortgagee or the mortgagee's assigns while in possession of the premises does not constitute a waiver of the foreclosure proceedings of the mortgage on the premises.

The mortgagee and the mortgagor may enter into an agreement to allow the mortgagor to bring the mortgage payments up to date with the foreclosure process being stayed as long as the mortgagor makes payments according to the agreement. If the mortgagor does not make payments according to the agreement, the mortgagee may, after notice to the mortgagor, resume the foreclosure process at the point at which it was stayed.

As such, all mortgage foreclosures would take place following a civil action in superior court. A mortgage foreclosure would be treated as a routine equity case estimated to have a filing fee of approximately $250.00.

The impact to servicers will be such that what was once a streamlined process, taking approximately 90-120 days, would be significantly extended to the same time frame that exists in other judicial states such as Maine, Vermont and Connecticut. This would also require careful scrutiny of demands to determine how to comply with the historical non-judicial paragraph 22 language in light of the new judicial process. Servicers can also expect a spike in contested matters by virtue of borrowers' filing answers, affirmative defenses, counterclaims, and engaging in discovery, as well having to prepare witnesses to testify at trial. Two aspects of the judicial process that were not mentioned are 1) the mediation process and 2) a non-judicial notice and publication requirement for the sale, but either could be added to the proposed bill at a later date. In conclusion, this proposed bill, if passed, would make foreclosing in the granite state much more difficult, time-consuming and expensive; and there is no doubt that all of the issues that have surfaced in the traditional judicial states will have to be similarly addressed and litigated in New Hampshire. Our office will provide updates as to future developments when they are available.

## STATE SNAPSHOT

# NEW YORK

# OBITUARY: The *MacPherson* Argument (and possibly some mortgages in your inventory!)

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**UNTIL NOW, no Appellate Division in New York State ruled on the *MacPherson* argument. *MacPherson* was a trial-level case out of Suffolk County that held that Paragraph 19 in the standard form Fannie/Freddie/MERS NY Instrument (which allows the borrower to reinstate the loan even if the lender required immediate payment in full) contractually precludes any argument that the commencement of a foreclosure action accelerates the loan until there is a judgment in that action. The *MacPherson* argument asserted that as long as Judgment of Foreclosure was not obtained in a prior action, the loan was never accelerated and, thus, the Statute of Limitations did not start to run. Some courts throughout the Downstate region adopted ; some rejected it.**

*MacPherson* was significant because it was the only option for lenders and servicers to save some mortgages in default from being time barred by the Statute of Limitations. The prosecution of some mortgages in default were significantly delayed through the near perfect storm of: the post-2008 financial crises; Court administrators' response to media reports of robo-signing; increased federal and state regulatory scrutiny on the default servicing and foreclosure process; the National Mortgage Servicing Standards resulting from a multi-State lawsuit against several lenders/services; multiple changes in New York State laws; the creation of the CFPB and introduction new regulations; the closing of the State's largest foreclosure firm; the expansion of the field of foreclosure attorneys in New York State and the following consolidation of servicers' vendor networks; and some mortgages being service released or sold (in some instances several times).

The confluence of aforementioned factors, and others not stated, created unprecedented delay in New York. Six or more years after some foreclosure actions were commenced, courts dismissed actions for not moving fast enough, defendants convinced Courts that they weren't properly served, or a servicer's inability to meet the Court's expectations of proving that a predicate notice was served. *MacPherson* was a weapon in foreclosure counsel's arsenal to ensure that the mortgage would not be time barred due to the six-year Statute of Limitations.

In *Bank of New York Mellon v. Dieudonne*, 2019 N.Y. Slip Op. 01732, _____ A.D.3d___ (2d Dept. 2019), the Appellate Division, Second Department considered the *MacPherson* argument and rejected it. The Court noted, "the language of paragraph 19 indicates that the plaintiff's right to accelerate the entire debt may be exercised before the defendant's rights under the reinstatement provision in paragraph 19 are exercised or extinguished... To the extent that decisional law [including *MacPherson*] interpreting the same contractual language holds otherwise, it should not be followed."

Said another way, Paragraph 19 did not prohibit acceleration, but gave the borrower the contractual ability to reverse the acceleration by curing the default and bringing the loan current.

Lenders and servicers can no longer rely on *MacPherson* to save a mortgage from Statute of Limitations purgatory, unless *Dieudonne* is reversed by the Court of Appeals.

# SCHILLER, KNAPP, LEFKOWITZ & HERTZEL, LLP

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Our mission is to aggressively protect our clients' interests. Our goal is to establish long-standing working relationships, founded on an understanding of our clients' business objectives, sustained by providing high-caliber professional services.  SKLH provides creditors' rights legal representation throughout New York, New Jersey, and Vermont, in all State and Federal Courts. With clients ranging from some of the region's largest lenders and mortgage servicers to local banks and credit unions, we counsel and assist our clients in managing their default portfolio – in a timely manner – while minimizing costs and providing quality legal services.  With five offices strategically located throughout our jurisdiction, our attorneys are accessible and able to provide full coverage for our clients.

## AT A GLANCE

YEAR FOUNDED: 1998
HQ: LATHAM, NY
ALFN MEMBER SINCE 2015
PRACTICE AREAS:
FORECLOSURE
BANKRUPTCY
LOSS MITIGATION
REO
EVICTIONS
LITIGATION
REAL ESTATE CLOSINGS

# New York Courts' Standard for Admissibility of Business Records

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**SERVICERS AND ATTORNEYS must rely on the business records exception to hearsay to address borrower challenges to compliance with RPAPL §1304 90 Day Notice ("90 Day Notice). Recent decisions across New York State have created real problems for servicers looking to rely on prior servicer records to show compliance with RPAPL §1304 as court enforcement of the business records exception has become more stringent.**

Pursuant to NY CPLR §4518 (a), a business record is be admissible if it "was made in the regular course of any business and [if] it was the regular course of such business to make it, at the time of the act, transaction, occurrence or event, or within a reasonable time thereafter." The courts in New York have went on to further explain the requirements for a business record when created by another entity. The courts have found that the mere filing of papers or records received by another entity is not enough to qualify them as a business record, rather that the threshold for the business records exception is met when that receiving entity can "...establish personal knowledge of the maker's business practices and procedures, or that the records provided by the maker were incorporated into the recipient's own records or routinely relied upon by the recipient in its business." (Deutsche Bank Natl. Trust Co. v Monica, 131 AD3d 737 [3d Dept 2015]).

However, recently we have seen the courts in New York expand the requirements of the business records exception when it comes to prior servicer records. Specifically in the 2nd Department, the rulings have required more than just incorporation of the documents or reliance on said documents for admissibility purposes and are now requiring personal knowledge of the prior servicer's mailing practices and procedures as well.

The 2nd Department's recent decision in Deutsche Bank Natl. Trust Co. v. Carlin, 152 A.D.3d 491 (2d Dept. 2017), illustrates this shift. In Carlin, the RPAPL §1304 90 Day Notice was sent by a prior servicer. Thereafter, the foreclosure was commenced by Plaintiff with reliance on the 90 Day Notice sent by the prior servicer. The borrower answered raising compliance with RPAPL §1304 as a defense. In addressing compliance with RPAPL §1304, Plaintiff provided an affidavit of the current servicer in which it cited the servicing records of the prior servicer reflecting that the 90 Day Notice was sent and copies of the 90 Day Notice. In its decision, the

**A best practice moving forward may be to get either an affidavit of mailing from the prior servicer or get the prior servicers mailing procedures to ensure that any future affiant can attest to them.**

Court went beyond the standard set in the Monica case and ruled that Plaintiff's affidavit was inadmissible as the affiant did not state personal familiarity with the practices and procedures of the prior servicer, despite their reliance on those prior servicer's records.

The 2nd Department is not alone in its increased scrutiny regarding the business records exception requirements. There have been similar decisions out of the other New York departments that have also called for increased scrutiny. See HSBC Bank USA v. Rice, 155 A.D.3d 443 (1st Dept. 2017) and TD Bank, N.A. v. Leroy, 121 A.D.3d 1256 (3d Dept. 2014). It should be noted that while all departments have increased scrutiny related to the business records exception, each has done so to varying degrees with the 2nd Department being the strictest.

## Industry Impact: What Does It Mean for Servicers

Servicers should take these issues into account during the on-boarding process for service transfers. A best practice moving forward may be to get either an affidavit of mailing from the prior servicer or get the prior servicers mailing procedures to ensure that any future affiant can attest to them. For those files that have already been transferred, servicers should review the business records to see if their affiants can speak to prior servicers mailing practices or work with their foreclosure counsel to see what other options may be available to them.

# STATE SNAPSHOT

# OHIO

# Ohio's New Compliance Requirements for Second Mortgages or Junior Liens, after Default

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**OHIO'S H.B. 489, EFFECTIVE MARCH 20, 2019, implements new Ohio Revised Code §1349.72. The statute applies to collections or attempts to collect any part of a debt in default, which is secured by a second mortgage or a junior lien on residential real property. Before attempting or attempting to collect any part of the debt, the creditor must send a written notice via U.S. mail to the debtor's residential address.**

The notice must be in at least 12-point type, and state the following:

- The name and contact information of the person collecting the debt;
- The amount of the debt;
- A statement that the debtor has a right to an attorney;
- A statement that the debtor may qualify for debt relief under Chapter 7 or 13 of the United States Bankruptcy Code; and
- A statement that a debtor that qualifies under Chapter 13 of the Bankruptcy Code may be able to protect the residential real property from foreclosure.

Upon receiving a debtor's written request, a copy of the note and the loan history must be provided. The statute imposes civil liability for restitution (but bars class action liability) for a compliance failure. However, the statute expressly provides that civil liability can be avoided if: (1) the failure was not intentional and resulted from a bona fide error, notwithstanding the maintenance of procedures reasonably adapted to avoid such an error; (2) within 60 days after discovering the error, the debtor is notified of the error and the manner in which full restitution is intended to be made; and (3) reasonable restitution is made to the debtor.

Aside from the obvious burden the statute imposes on creditors, without significant benefit to debtors, the lack of clarity of the statute is a cause for concern. Many clients have asked questions, which the statute fails to address. Below are some questions clients have asked, and some answers.

**QUESTION:** Is the creditor required to send the statutory notice before sending a late notice or the next month's statement showing a past-due amount?

**ANSWER:** Sending a late notice or the next month's statement showing a past-due amount is likely to be deemed an attempt to collect, and therefore, subject to the statute's requirements. Sending the statutory notice immediately when the loan becomes in default will protect the creditor from claims of noncompliance relating to subsequent written or oral communications.

**QUESTION:** After the due date, but before the grace period expires, can the creditor send a courtesy notice to the debtor as a reminder to make the payment within the grace period, without first sending a disclosure?

**ANSWER:** The statute only applies if the debt is in default. If the note does not provide a grace period, the loan becomes in default, the day after a missed payment was due. However, if the note provides a grace period, the debt is not in default until the grace period for the missed payment has expired. Therefore, the creditor should be allowed to send

**Aside from the obvious burden the statute imposes on creditors, without significant benefit to debtors, the lack of clarity of the statute is a cause for concern.**

a courtesy notice before the grace period expires, without first sending the statutory notice.

**QUESTION:** Is the creditor required to wait, say three days after sending the notice, to ensure the debtor has received it before the creditor calls the debtor or engages in other collection efforts?

**ANSWER:** The statute requires that the notice be sent but it does not require that the notice be received by the debtor before the creditor attempt to collect. It follows that as soon as a properly addressed notice is in the Post Office's control, (i.e. deposited in a Post Office mailbox or dropped off at the Post Office), the creditor may proceed with collection efforts.

**QUESTION:** Is the creditor required to send a statutory notice to all debtors against whom the creditor filed judgment liens in the past?

**ANSWER:** Under Ohio law, a judgment lien attaches to all real property owned by the debtor in the county in which the lien is filed, including residential real property. If the judgment lien has not expired or been released, the disclosure must be sent before collecting or attempting to collect any part of the debt.

**QUESTION:** If the creditor didn't send a notice, may the creditor apply a payment it receives on a loan in default, as long as it didn't call or write to the debtor about paying?

**ANSWER:** The statute requires a notice before: (1) collecting or (2) attempting to collect. Receiving and applying a payment may be deemed "collecting" even if no call was made or no correspondence was sent to the debtor.

**QUESTION:** If the mortgage was originally a second mortgage, but the first mortgage subsequently was released, is the creditor still required to send a disclosure?

**ANSWER:** The statute doesn't clearly answer this question. To be on the safe side, for the purpose of this statute, I recommend assuming "Once a second mortgage, always a second mortgage." In other words, send a notice when the loan becomes in default.

**QUESTION:** If the creditor has verified the debtor is deceased, is the creditor still required to send a disclosure?

**ANSWER:** The statute does not provide an exception for a situation where the creditor has verified the debtor is deceased. Therefore, before submitting a claim to the decedent's estate or commencing a foreclosure on the mortgage, the creditor must, nevertheless, send the disclosure, presumably to the last residential address used by the debtor prior to the debtor's death. In this situation, the best practice would probably be to address the letter to "(debtor name) or next of kin."

**QUESTION:** How many times must the creditor send a statutory notice?

**ANSWER:** One notice should be sufficient to cover all subsequent oral or written attempts to collect until the default is cured. However, if the default is cured, and a subsequent default occurs, a new notice should be sent.

Industry lobbyists are at work to try to convince the Ohio Legislature to repeal or at least significantly amend this problematic law. Let's hope they succeed. In the meantime, creditors should seek the advice of counsel and implement proactive procedures which will help avoid claims or counterclaims alleging non-compliance. The opinions in this article do not constitute legal advice.

## STATE SNAPSHOT

# RHODE ISLAND

## STATE SNAPSHOT

# Rhode Island Federal Court Ruling has Potential to Change GSE Nonjudicial Foreclosure Process Across the Country

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**IN AUGUST of this year, the United States District Court for the District of Rhode Island was presented two cases seeking a ruling that Fannie Mae (FNMA) and Freddie Mac (FHLMC) are government actors, and thus, violated Fifth Amendment due process rights by conducting non-judicial foreclosures. See Sisti v. Federal Housing Finance Agency ("FHFA"), 2018 WL 3655578 (D.R.I. Aug. 2018). FHFA, FNMA and FHLMC moved for judgment on the pleadings, which was denied by Judge McConnell as "…it is not 'beyond doubt' that plaintiffs cannot prove their claims against the agency." Based on the denial, FHFA, FNMA and FHLMC filed a motion to amend the August 2, 2018 order to include the certification necessary to allow defendants to petition the US Court of Appeals for the First Circuit for interlocutory review under 28 U.S.C. §1292(b). On October 15, 2018, Judge McConnell denied the motion allowing the case to proceed.**

The case stems from two unrelated foreclosures: a 2012 foreclosure sale of Sisti's home by FHLMC and a 2014 foreclosure sale of Boss' home by FNMA. In both instances, the properties sold back to the respective GSEs and state court actions to evict commenced. Both borrowers seeking to defend the evictions sued FNMA, FHLMC and FHFA in separate Federal Court actions, alleging that the entities are government actors and violated the borrowers' Fifth Amendment due process rights by conducting non-judicial foreclosures. The defendants moved for judgment on the pleadings, and the cases were consolidated for oral argument as they presented the same legal issues.

In denying defendants' (FHFA, FNMA and FHLMC) the motion for judgment on the pleadings, the Court found that the Plaintiffs could prove that FNMA and FHLMC are government actors for the purposes of constitutional claims and thus the case could proceed. This was based on the Court's application of the three-part test articulated by the Supreme Court in Lebron v. National Railroad Passenger Corp. 513 U.S. 374 (1995) which asked: 1) whether the government created the entity by special law; 2) whether the entity furthers governmental objectives; and 3) whether the government retains for itself "permanent authority" to appoint a majority of the directors of that entity. In dispute amongst the parties was the third prong of this test, namely whether the government has retained permanent authority to appoint a majority of the directors of that entity. Many courts in the past have found, and FNMA, FHLMC and FHFA argued, that FHFA's conservatorship of the GSEs is temporary under the Housing and Economic Recovery Act (HERA). This Court however rejected this argument, concluding that FHFA "…effectively controls Fannie Mae and Freddie Mac permanently" because of its control over the duration of the conservatorship, which Judge McConnell described as "in perpetuity."

This recent ruling allows the case to move forward and is not a decision on the merits. If GSEs are found to be government actors, then constitutional protections may apply which could trigger changes to the GSE non-judicial foreclosure process across the country. This could range from foreclosing in the servicer's name to protections found in judicial foreclosures, such as the opportunity to have an evidentiary hearing, to be represented by counsel, or to have a neutral hearing officer adjudicate the matter.

STATE SNAPSHOT

# VIRGINIA

# Virginia Circuit Court Decision Highlights Increased Likelihood of Rescission as a Remedy in Post-Foreclosure Litigation

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**THE NORFOLK CIRCUIT COURT recently handed down a new opinion regarding the availability of foreclosure rescission in Virginia. In recent years, Virginia courts have been dismissive of post-sale requests for rescission, except in instances of fraud, collusion, or inadequate sale price. However, in *Ononuju v. Va. Hous. Dev. Auth.*, 2019 Va. Cir. LEXIS 33, the circuit court overruled the lender's demurrer and held that rescission is also available where there is a material breach of the deed of trust. In order to understand the circuit court's decision, one must look backwards at the Virginia Supreme Court cases that led to this result.**

*Ononuju* specifically concerns a request for rescission based on a material breach of the deed of trust caused by the failure to hold a face-to-face meeting prior to foreclosure of a HUD loan. In *Matthews v. PHH Mortg. Corp.*, 283 Va. 723 (2012) the Virginia Supreme Court held that the face-to-face meeting is a condition precedent to foreclosure of a HUD loan and that failure to hold the meeting is a material breach of the deed of trust. In *Squire v. Va. Hous. Dev. Auth.*, 287 Va. 507 (2014), the Court issued a similar ruling to *Squire* and, additionally, upheld the lower court's decision to deny rescission because it was not an available post-sale remedy.

In 2015, almost exactly one year after the Squire decision, the Supreme Court issued *Ramos v. Wells Fargo*, 289 Va. 321 (2015). In *Ramos*, the Court again considered an alleged failure to hold the face-to-face meeting. The Court explicitly held that rescission is not an available remedy for an alleged failure to hold the face-to-face meeting. See *Ramos* at 324. Based on its earlier holding in Squire, the Court stated that rescission was only available in cases of fraud, collusion, or a grossly inadequate sale price. After *Ramos*, the landscape appeared to be settled.

However, in June 2016, the Supreme Court issued *Parrish v. Fannie Mae,* 292 Va. 44 (Va. 2016). The primary holding in Parrish relates to post-foreclosure eviction. However, the Court also discussed the remedy of rescission and stated that the list in *Ramos* is not exhaustive. See Parrish at 52. In addition to the three possibilities in *Ramos*, the Court opined that a sale may be set aside when it was "conducted in material breach of the deed of trust." *Id.* With that one sentence, the Virginia Supreme Court changed the law on availability of rescission.

The Norfolk Circuit Court has followed these previous cases and issued the decision in *Ononuju*. Like in *Matthews and Squire*, the failure to hold the face-to-face meeting is a material breach of the deed of trust. As stated in Parrish, rescission is available as a remedy for the breach. It is worth noting that, in making this decision, the circuit court considered the purchaser's knowledge, suggesting that there may have been a different result if the property had sold to a third party.

This case will bolster plaintiffs in other jurisdictions and provide circuit courts a basis to allow cases to continue when rescission is the requested remedy. In response to this development, lenders will want to continue to be diligent in meeting the HUD requirement for face-to-face meetings prior to foreclosure. Further, when faced with a pre-sale challenge to a foreclosure, lenders and servicers may want to being discussing whether the challenge is something that could withstand demurrer and lead to lengthy litigation. Finally, it is worth considering whether servicers and lenders want to appeal some of these cases to the Virginia Supreme Court when receiving negative rulings. The plaintiff's bar has been consistently appealing cases to the Virginia Supreme Court and they are seeing results. At some point, the lenders side may need to do the same.

Virginia post-foreclosure litigation has become much more complicated following the Parrish decision, highlighted by the recent decision in Norfolk to allow rescission as a post-sale remedy for a material breach of the deed of trust. More circuit courts will likely follow. When that happens, be sure to reach out to your Virginia counsel for review and discussion.

STATE SNAPSHOT

# WASHINGTON

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## There Is No Such Thing as a Free House… Well, in the State of Washington, There Could Be…

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**OVER THE PAST several years, those who service loans in the State of Washington[1] have seen a dramatic rise in the number of lawsuits in which delinquent borrowers seek to quiet title to their homes on the grounds that lenders are barred from foreclosing based on Washington's six year statute of limitations.**

Historically, these lawsuits allege that the foreclosure is time-barred because Notice of Acceleration letters have been issued more than six years prior to the initiation of the foreclosure process. However, based on recent case law, we foresee a very real danger of an increase in the amount of lawsuits brought by borrowers who have had their debts discharged in bankruptcy and either continued to make their monthly payments following their discharge, or engaged in a game of cat-and-mouse with the servicer, as result of which the servicer did not commence foreclosure within the six-year period following the discharge. Indeed, in at least one instance, the borrowers who obtained a bankruptcy discharge order successfully quieted title to their home against Fannie Mae based on Fannie Mae's failure to foreclose with the six-year period. The potential of these lawsuits – and given the result discussed above – creates a significant risk to the mortgage industry, which should be addressed, assessed, and mitigated by lenders and servicers.

Washington RCW 7.28.300 permits title owners – not necessarily borrowers – to commence quiet title actions against secured lenders to eliminate liens secured by the property based on the lender's failure to timely foreclose:

> The record owner of real estate may maintain an action to quiet title against the lien of … deed of trust on the real estate where an action to foreclose such… deed of trust would be barred by the statute of limitations, and, upon proof sufficient to satisfy the court, may have judgment quieting title against such a lien.

The applicable statute of limitations within which a lender can foreclose for purposes of RCW 7.28.300 is six years from the date of acceleration of the debt. Recently, in *Edmundson v. Bank of Am., NA*, 194 Wn.App. 920, 931 (2016) ("*Edmundson*"), *Silvers v. U.S. Bank Nat. Ass'n*, 2015 WL 5024173 (W.D. Wash. Aug. 25, 2015) ) ("*Silvers*"), and *Jarvis v. Fed. Nat'l Mortg. Ass'n*, 2017 WL 1438040 (W.D. Wash. Apr. 24, 2017 ("Jarvis"), Washington's State and Federal Courts addressed the impact of a bankruptcy discharge on the lenders' ability to foreclose within the purview of RCW 7.28.300.

In *Edmundson*, the Court of Appeals held that the borrowers' bankruptcy discharge, which terminated their personal liability under the promissory note, triggered the statute of limitations within which the lender was entitled to foreclose. The Court reasoned that since the borrowers owed no future payments after the discharge of their personal liability, the date of their last-owed payment kick-started the deed of trust's final limitations period. *Id.* at 931.

The same outcomes were reached by the Federal Courts in *Silvers* and *Jarvis*. In *Silvers*, the Court reasoned that because the bankruptcy discharge re-

[1] While the purpose of this article is to discuss Washington State law, the analysis herein could be equally applicable to any State which has laws governing statute of limitations on foreclosure.

lieved the borrowers' personal liability on the note, no future payments were owed and no installments capable of triggering the limitations period remained. *Id.* at *4. Accordingly, the Court held that the six-year limitations period accrued at the time of the borrowers' last missed payment preceding their discharge of personal liability. *Id.*

In *Jarvis*, the Court actually granted the borrowers motion for summary judgment and quieted title pursuant to RCW 7.28.300 in borrowers' favor and against Fannie Mae, finding that the borrowers' bankruptcy discharge order triggered Washington's statute of limitations for foreclosure. The Court noted that "[t]he [bankruptcy] discharge … alert[s] the lender that the limitations period to foreclose on a property held as security has commenced" and that "[t]he last payment owed commences the final six-year period to enforce a deed of trust securing a loan. This situation occurs… at the payment owed immediately prior to the discharge of a borrower's personal liability in bankruptcy, because after discharge, a borrower no longer has forthcoming installments that he must pay." *Id.* at 2.

The Court rejected Fannie Mae's public policy argument that "tying the discharge of a borrower's personal liability to a lender's right to enforce a deed of trust would automatically accelerate future installments secured by the deed of trust without the lender's consent and to the borrower's detriment." Instead, the Court found that Washington law supported the termination of Fannie Mae's secured interest under RCW 7.28.300:

The discharge of a borrower's personal liability on his loan—the cessation of his installment obligations—is the analog to a note's maturation. In both cases, no more payments could become due that could trigger RCW 4.16.040's limitations period. The last-owed payment before the discharge of a borrower's personal liability on a loan is the date from which a secured creditor has six years to enforce a deed of trust securing the loan.

The Jarvises stopped repaying their loan, Fannie Mae did not accelerate their obligation, and the Bankruptcy Court discharged their debts on February 23, 2009. They did not reaffirm. Their last installment payment owed, therefore, was the one immediately prior to their discharge. Over six years passed between that date and the date they filed for quiet title, February 11, 2016. RCW 4.16.040 forecloses Fannie Mae's right to enforce the deed of trust against them.

*Jarvis* at**3-4.

**This result clearly demonstrates the potential danger to secured lenders in situations involving accounts discharged in bankruptcy and makes it imperative that lenders and servicers remain vigilant in tracking all of such discharged accounts to ensure that their security interests remain protected.**

This result clearly demonstrates the potential danger to secured lenders in situations involving accounts discharged in bankruptcy and makes it imperative that lenders and servicers remain vigilant in tracking all of such discharged accounts to ensure that their security interests remain protected. This is especially important in situations where the borrowers, having obtained orders discharging their debts, continue to make monthly payments on their loans, thus precluding foreclosure.

While the *Jarvis* court noted that, following bankruptcy, "a borrower and a lender may agree to reaffirm or renegotiate the borrower's dischargeable debt", clearly more effort is needed, as the borrowers are not required to agree to reaffirm their debt and/or to re-negotiate. Accordingly, in situations where the borrowers continue making their monthly payments (or at least a portion of them), we recommend tracking the file and discussing the lender's options with an attorney before the statute of limitations expires rendering the security unenforceable. On the other hand, in situations where the borrowers remain delinquent on their payments, we recommend that lenders ensure that the foreclosure proceedings are initiated before the expiration of the six-year statute of limitation period.