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CONSUMER FINANCE REPORT

CALIFORNIA DEVELOPMENTS FROM A BUSINESS PERSPECTIVE

Kerry W. Franich and Elizabeth Holt Andrews, Editors

Summer 2018

Is Class Arbitration a Non Sequitur?

By:
Donald J. Querio

By:
Erik Kemp

The fight over the validity of class action waivers in arbitration contracts is largely over. In *Concepcion v. AT&T Mobility*, 563 U.S. 333, 352 (2011), the U.S. Supreme Court ruled that under the Federal Arbitration Act, an arbitration clause requiring bilateral arbitration and expressly barring class actions is enforceable. (For a discussion of the rear-guard effort to resist this simple rule, see our prior article, "The California Supreme Court Continues Its Resistance to Arbitration." (Winter 2018).) In the wake of *Concepcion*, most arbitration clauses in consumer finance contracts contain such waiver language. But for those clauses which don't contain such a waiver, the question remains whether a class arbitration—the worst of all worlds for a corporate defendant—is possible.

For over a decade, the issue of whether a class can be certified and class claims resolved in arbitration has turned on whether the arbitration clause contemplates such a procedure. (See our prior article, "Silence Is Not Always Golden" (Winter 2015).) Obviously, an arbitration clause that is silent on the subject leaves a lot of room for mischief. Even the U.S. Supreme Court has struggled with the question of how to interpret such silence, including the antecedent issue of whether the decision was for the court or the arbitrator. Compare *Green Tree Fin. Corp. v. Bazzle*, 539 U.S. 444, 447 (2003) with *Oxford Health Plans LLC v. Sutter*, 569 U.S. 564, 565–66 (2013) and *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662, 666 (2010). The issue is once more before the High Court. *Lamps Plus, Inc. v. Varela*, 701 F. App'x 670 (9th Cir. 2017), *cert. granted*, 138 S. Ct. 1697 (U.S. Apr. 30, 2018) (No. 17-988).

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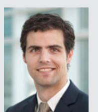
LETTER FROM THE EDITORS



By:
Kerry Franich

By:
Elizabeth Holt Andrews

Welcome to the Summer 2018 Consumer Finance Newsletter! In this issue you'll find a feature article by Don Querio and Erik Kemp on recent developments in the law of class action arbitrations. There are also articles by Bernard J. Kornberg and Stephen D. Britt discussing important new case law in the arenas of bankruptcy discharge and debt collection.

California's overheated housing market continues to drive changes in the regulatory environment, requiring a nimble response from mortgage lenders and servicers. For example, many key provisions of the state Homeowner Bill of Rights have sunsetted and others have taken their place—changes which are chronicled here by Andrew W. Noble. And as Genevieve R. Walser-Jolly and Loren Coe explain, a new California bill is coming into effect that removes reverse mortgages from the state's successor-in-interest rules. On the federal side, several West Coast lawmakers have proposed a new bill in the U.S. House of Representatives that would strengthen protections for surviving spouses of reverse mortgage borrowers, as explained by Ms. Walser-Jolly and Katherine Figueroa.

Meanwhile, Mr. Coe also discusses a new published opinion from the First Appellate District in San Francisco that restricts trial courts from ordering the sale of property in a partition action before determining the interests of the putative owners. Appellate group chairman Jan T. Chilton rounds out this quarter's offerings with summaries of other interesting case developments in financial services from the California appellate courts and the Ninth Circuit.

We hope you enjoy this edition of the newsletter. If there are topics that you'd like to see analyzed by Severson's team of experts in financial services law, please let us know at kwf@severson.com and eha@severson.com.

IN THIS ISSUE

APPELLATE UPDATE....5
BANKRUPTCY....7
CLASS ACTION LITIGATION....1
DEBT COLLECTION....3
HOMEOWNER BILL OF RIGHTS....12
REAL ESTATE LITIGATION....11
REVERSE MORTGAGES....8,9

"Class Arbitration..."
— from page 1

Recently, a district court in the Southern District of New York took an entirely different approach to the question and concluded that an arbitrator would violate the due process rights of absent class members if he or she attempted to certify and arbitrate the claims of a traditional opt-out class, at least absent an express term in the arbitration agreement of every putative class member granting such a power. *Jock v. Sterling Jewelers*, 284 F. Supp. 3d 566 (S.D.N.Y. 2018). It is doubtful that such a contractual grant of authority exists in any consumer contract. But even if it did, the Court expressly noted that it still might be a due process violation to allow an opt-out class to be certified by an arbitrator. If this decision withstands appeal to the Second Circuit, it will be the practical end of the attempts to avoid *Concepcion* by pursuing a class arbitration.

<u>The Background of *Jock*: Round One in the Second Circuit</u>

Our story begins ten years ago when Laryssa Jock filed a putative class action against Sterling Jewelers alleging gender discrimination. Sterling filed a motion to compel arbitration, and the proceedings have been side-tracked ever since. In keeping with the plurality opinion in *Bazzle*, the district court held that because the arbitration clause did not address the class issue and the grant of authority to the arbitrator was broad, the permissibility of a class arbitration was for the arbitrator to decide. The arbitrator ruled that a class action was permissible, and Sterling promptly sought review by the Second Circuit.

While Sterling's appeal was pending, the U.S. Supreme Court handed down *Stolt-Nielsen*, which brought some clarity about how to deal with arbitration clauses without class waivers. The High Court held that in order to have a class arbitration, the parties must have affirmatively agreed that such a procedure was within the scope of the arbitrator. But *Stolt-Nielsen* stopped short of suggesting how the lower courts should make that determination. The parties in *Stolt-Nielsen* had stipulated that the only evidence of their intent was the "silent" arbitration agreement, allowing the Court to rule as a matter of law that the arbitrator could not hear class claims.

In *Jock*, the Second Circuit temporarily remanded the case to the district court to determine the impact, if any, of *Stolt-Nielsen*. The district court promptly reversed its prior ruling and vacated the arbitrator's decision to proceed with a class arbitration. Like the proverbial ping-pong ball, the case went back up to the Second Circuit for the continued review of the district court's now-amended decision. The Second Circuit concluded that the district court had read too much into *Stolt-Nielsen* and should have accepted the arbitrator's determination that the parties' agreement was broad enough to allow a class arbitration. *Jock v. Sterling Jewelers Inc.*, 646 F.3d 113, 115 (2d Cir. 2011). The district court was ordered to accept the arbitrator's decision and let the matter proceed as a class arbitration.

<u>*Jock*: Round Two in the Second Circuit</u>

Just when it looked like the dust had settled, the U.S. Supreme Court issued its *Oxford Health Plans* decision further "clarifying" how the lower courts were supposed to handle "silent" arbitration agreements. In a unanimous ruling, the High Court said that where the parties clearly invest an arbitrator with the power to interpret their arbitration agreement, the court must abide by the arbitrator's decision that a class arbitration is permissible. But unanimity can be deceptive. Justice Alito issued a concurring opinion which raised an even more fundamental due process question: does the arbitrator ever have the power to interpret the arbitration agreements of putative class members who are not present in the arbitration proceeding? The question was rhetorical and suggested that only those class members who somehow opt in to the arbitration proceeding can be bound by the arbitrator's interpretation of their arbitration agreement, even if it is identical to the one at issue.

In *Oxford Health*, the due process issue was not squarely before the court because neither the district court nor arbitrator had yet considered it. In *Jock*, the issue was unavoidable. As noted above, in Round One the Second Circuit had ordered the district court to accept the arbitrator's decision. In 2015, the arbitrator certified a class of 70,000 Sterling Jewelers employees and was prepared to arbitrate the class claims when Sterling again appealed to the Second

(continues on page 3)

"Class Arbitration..."
— from page 2

Circuit, raising the due process argument previewed by Justice Alito in *Oxford Health*. Jock argued that the issue of class arbitration had already been decided by the arbitrator and was law of the case. But the Second Circuit didn't buy it, noting that its prior decision affirming the arbitrator's interpretation of the arbitration agreement did not squarely address "whether the arbitrator exceeded her authority in certifying a class that contained absent class members who have not opted in." *Jock v. Sterling Jewelers, Inc.*, 703 F. App'x 15, 18 (2d Cir. 2017).

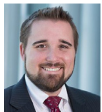
The Implications of the District Court's *Jock* Decision

The implications of the district court's latest decision, if upheld by the Second Circuit, would be profound. In practical terms, it would mean that a compulsory one-on-one arbitration clause in a consumer finance contract would preclude an opt-out class action, both in court and in arbitration. Although the theoretical possibility of bringing an opt-in class in arbitration remains, it would be highly unlikely ever to occur. Based on the logic of Justice Alito's concurrence in *Oxford Health* as applied by the district court in *Jock*, the plaintiff seeking such a class would have to show that the arbitration clause of every putative class member expressly contemplated such a procedure. Even then, the issue remains open whether such finding could ever be within the scope of a single arbitrator. In effect, this would put a constitutional underpinning to the *Concepcion* majority opinion's holding that there is a fundamental inconsistency between arbitration and class actions.

For more information on the Jock *decision and its implications for class arbitrations, please contact Donald J. Querio at djq@severson.com or Erik Kemp at ek@severson.com.*

DEBT COLLECTION

Who Is A "Debt Collector," And What Is A "Debt Collection Practice" For Purposes of FDCPA? A Tale Of Two Cases



By:
Stephen D. Britt

On May 24, 2018, the Fourth Appellate District of California, Division One, dealt a blow to mortgage servicers, holding that servicers who acquire servicing rights after the borrower's loan has fallen into default are considered "debt collectors" for purposes of 15 U.S.C. §1692a(6) of the Fair Debt Collection Practices Act ("FDCPA"). The borrower/plaintiff in *Randall v. Ditech Financial, LLC*, 23 Cal. App. 5th 804 (2018), alleged that the entity who acquired the servicing rights to his loan after it had fallen into default committed several actions to prevent him from reinstating his loan, such as (a) providing him with a reinstatement amount that "was inconsistent with the amount of payments [the borrower] had missed," (b) failing to cancel the trustee's sale after he had paid the full reinstatement amount provided by the servicer, and (c) continuing to charge him "improper fees and charges" after he had reinstated. *Id.* at 810.

The *Randall* Court found that the borrower's allegations that the servicer was "overcharging [him] to reinstate his loan and charging default fees and costs for a loan that [was] not in default are attempts to collect money and, consequently, are actionable under section 1692f(1) [of the FDCPA]." *Id.* And the court held that the borrower could amend his complaint to state a claim for violation of 15 U.S.C. § 1692(f)(6), based on the loan servicer's continuing efforts to pursue non-judicial foreclosure after the borrower had reinstated the loan. *Id.* at 811.

By contrast, in *Ho v. ReconTrust Co., N.A.*, 858 F.3d 568 (9th Cir. 2017), the Ninth Circuit Court of Appeals held that "[a]n entity does not become a general 'debt collector' if its 'only role in the debt collection process is the enforcement of a security interest.'" *Id.* at 573 (quoting *Wilson v. Draper & Goldberg, P.L.L.C.*, 443 F.3d 373, 378 (4th Cir. 2006)). The *Ho* Court held that the foreclosure trustee defendant would only be liable under the FDCPA "if

(continues on page 4)

"Who Is A "Debt Collector,"... "
— from page 3

it attempted to collect money from" the borrower, and non-judicial foreclosure proceedings did not meet this narrow definition. *Id.* at 571. The Ninth Circuit reasoned that "[t]he object of a non-judicial foreclosure is to retake and resell the security, not to collect money from the borrower." *Id.*

In reaching this conclusion, the *Ho* Court performed an extensive review of various FDCPA provisions and how they conflict with California's non-judicial statutory scheme, and noted that "a trustee could not comply with California law without violating the FDCPA" under the broad definition urged by the borrower. *Id.* at 575. The Ninth Circuit also expressed its hesitancy "to accept an interpretation of a federal statute that would generate conflict between state and federal law." *Id.* at 576. As a result, it concluded that the act of recording foreclosure notices required under California law "does not constitute debt collection activity under the FDCPA." *Id.* at 574 (quoting *Pfeifer v. Countrywide Home Loans, Inc.*, 211 Cal. App. 4th 1250, 1264 (2012)). It should be noted that the *Ho* decision included a vociferous dissent urging the court to adopt a broader definition of "debt collector," more in line with *Randall*'s definition and that of some other federal circuit courts.

How did these courts reach their seemingly divergent positions? As the Ninth Circuit explained in the *Ho* decision: "Even courts holding that foreclosure is debt collection have recognized that the term 'debt collector' is cryptic." The *Randall* decision appears to limit "debt collectors" to entities who acquire servicing rights post-loan default. Numerous other courts have found that original creditors, on the other hand, are not "debt collectors" within the meaning of the FDCPA. *See, e.g.*, *Obduskey v. Fargo*, 879 F.3d 1216, 1220 (10th Cir. 2018); *Rowe v. Educ. Credit Mgmt. Corp.*, 559 F.3d 1028, 1031 (9th Cir. 2009); *Perry v. Stewart Title Co.*, 756 F.2d 1197, 1208 (5th Cir. 1985); *Pratap v. Wells Fargo Bank, N.A.*, 63 F. Supp. 3d 1101, 1113 (N.D. Cal. 2014).

The contrasting factual allegations presented in the *Randall* and *Ho* cases may also help clarify what constitutes a "debt collection practice" under the FDCPA. *Randall* reflects courts' apparent unwillingness to exclude improprieties outside the scope of routine non-judicial foreclosure proceedings from this definition. Another pertinent example can be found in a recent Ninth Circuit decision that held "a debt arising from [a borrower's] failure to pay homeowner association fees as part of a judicial foreclosure scheme . . . constitutes debt collection under the FDCPA." *McNair v. Maxwell & Morgan PC*, 893 F.3d 680, 683 (9th Cir. 2018).

By contrast, *Ho* follows a line of cases holding that the act of foreclosing on a deed of trust itself does not constitute a "debt collection practice." *See, e.g.*, *Altman v. PNC Mortgage*, 850 F. Supp. 2d 1057, 1071 (E.D. Cal. 2012); *Izenberg v. ETS Services, LLC*, 589 F. Supp. 2d 1193, 1199 (C.D. Cal. 2008); *Pfeifer*, 211 Cal. App. 4th at 1264.

The Future of FDCPA Litigation For Lenders & Servicers

While the FDCPA's definitions of "debt collectors" and "debt collection practices" remain open to judicial interpretation, the United States Supreme Court appears poised to provide answers during its next term. On June 28, 2018, the Court granted a borrower's petition for writ of certiorari to challenge the Tenth Circuit's holding that original lenders are not "debt collectors" and non-judicial foreclosure proceedings are not "debt collection practices" for purposes of the FDCPA. *Obduskey v. McCarthy & Holthus LLP*, 879 F.3d 1216 (10th Cir. 2018), *cert. granted*, 86 U.S.L.W. 3650 (U.S. June 28, 2018) (No. 17-1307).

Until the Supreme Court weighs in, the issue of whether or not a servicer is a "debt collector" under the FDCPA appears dependent on when it acquired its servicing rights. And, courts appear likely to find that an entity's actions constitute "debt collection activities" only when its actions exceed the scope of routine non-judicial foreclosure proceedings.

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Financial Services Appellate Highlights from Q2 2018

By:
Jan T. Chilton

By:
Elizabeth Holt Andrews

TELEPHONE CONSUMER PROTECTION ACT

Fober v. Management & Technology Consultants, LLC

886 F.3d 789 (9th Cir. 2018)

Plaintiff could not state a Telephone Consumer Protection ACt claim against defendant HMO after it auto-dialed her seeking feedback on one of its in-network doctors, because she gave her consent to be contacted for a variety of purposes including quality improvement.

When she enrolled in Health Net's HMO, Fober gave her cell phone number and consented to its use and disclosure for a variety of purposes including quality improvement. She was later auto-dialed repeatedly by the defendant seeking her response as to the quality of services she had received from a particular Health Net doctor. The nature of the call determines whether it falls within the scope of the called person's express prior consent. Here, defendant's calls related to quality improvement and so fell within the scope of plaintiff's prior consent even if the services in question were rendered by a network doctor rather than Health Net itself. And it does not matter that the call was placed by another entity, rather than Health Net, and allegedly not on Health Net's behalf since plaintiff had consented to disclosure and use of her number for the specified purposes including quality improvement.

FAIR DEBT COLLECTION PRACTICES ACT

Echlin v. PeaceHealth

887 F.3d 967 (9th Cir. 2018)

Defendant was sufficiently engaged in collection efforts to qualify as a debt collection agency and hence did not run afoul of the Fair Debt Collection Practices Act's prohibition on creating the false belief in a consumer that a person other than the creditor is participating in the collection of the debt.

The FDCPA (15 USC § 1682j) bans the practice, called flat-rating, of creating the false belief in a consumer that a person other than the creditor is participating in the collection of the debt. The prohibition was intended to bar a company that merely sells and sends form collection letters for a creditor (normally at a flat rate) from creating the false and supposedly more intimidating impression that the creditor had hired a real collection agency to collect the debt. This decision affirms a summary judgment for defendants on a § 1682j claim finding that the organization did more than simply send letters—it responded to debtors' calls and letters, maintained a website and drafted its own correspondence with debtors. This was enough participation in the collection efforts to make it a true debt collector even though it reassigned the debts back to the creditor for collection after sending only two collection letters to the debtor if it received no response to that correspondence.

UNLAWFUL DETAINER

Hsieh v. Pederson

23 Cal. App. 5th Supp. 1 (Cal. App. Dep't Super. Ct. 2018)

Holidays and weekends count against the running of the three-day notice to quit period in unlawful detainer unless the landlord states that the required rent payment may only be remitted by mail.

Under Cal. Civ. Proc. Code § 1161(2), a three-day notice to quit may require payment by mail only or it may, at the landlord's choice, allow payment in person if it states the receiving person's telephone number and hours he or she is open to receive rent. Since the landlord chose to permit payment in person or by mail, holidays and weekends counted towards the three days—they don't if only payment by mail is permitted. Here, sufficient days elapsed after service and before the suit was filed to allow the defendant the full notice period. So judgment for defendant was reversed.

(continues on page 6)

"2018 Changes..."
— from page 5

FORECLOSURE

Hacker v. Homeward Residential, Inc.

23 Cal. App. 5th 111 (2018)

A trial court should have given mortgage plaintiff further leave to amend a complaint to allege that party who foreclosed lacked any legal interest in the deed of trust, due to errors in the property's chain of title.

The trial court erred in denying plaintiff leave to amend. Plaintiff allegedly acquired title from a supposed purchaser at a short sale and claimed to be able to allege that the party that later foreclosed on the property lacked any interest in the deed of trust because it was the assignee of a second assignment from the same owner which had earlier assigned the same deed of trust to a different party and thus lacked any interest in the deed of trust at the time of the second assignment—the same sort of allegation that *Sciarratta v. U.S. Bank, Nat'l Ass'n*, 247 Cal.App.4th 552, 565–66 (2016) found to state a viable claim.

MORTGAGE LENDING

Tindell v. Murphy

22 Cal. App. 5th 1239 (2018)

An appraiser hired to provide an appraisal for the lender's use does not owe the borrower a duty of care.

The sham pleading doctrine prevented plaintiffs from shifting without explanation from an original complaint which alleged seller defrauded them by representing house was "modular" rather than "manufactured"—an allegation refuted by an appraisal report attached to the complaint which revealed the true condition—to an amended complaint which alleged seller defrauded plaintiffs by saying the house was manufactured in 1979 rather than its true date, 1972. Following *Willemson v. Mitrosilis*, 230 Cal.App.4th 622, 632 (2014), this opinion holds that an appraiser hired to provide an appraisal for the lender's use does not owe the borrower a duty of care.

DEBT COLLECTION

Professional Collection Consultants v. Lujan

23 Cal. App. 5th 685 (2018)

In collections suit, collection agency plaintiff was held to Delaware's three-year statute of limitations—which was the jurisdiction selected in the credit card account agreement's choice of law clause—as opposed to the four-year limitations period in California, where the suit was brought.

Lujan, a California resident, held a Chase credit card. His account agreement contained a Delaware choice of law clause. The Delaware 3-year limitations period applied to and barred Chase's (and its debt collector plaintiff's) suit to collect amounts Lujan owed on the credit card even though suit was brought in California where but for the choice of law clause, the suit would have been timely under California's 4-year limitations provision. Plaintiff could not evade the limitations bar by pleading common counts for a book account or account stated rather than for breach of contract. The limitations period is governed by the gravamen of the suit, not the legal theory of the complaint. Also, Delaware's statute tolling the limitations period while the defendant is outside Delaware is not enforced as it would effectively eliminate the statute of limitations.

When You Aren't Sure If the Attorneys' Fee Award Is Discharged, You Can Ask

By:
Bernard J. Kornberg

When a debtor receives a bankruptcy discharge, it creates "an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor." 11 U.S.C. § 524(a)(2). This injunction applies to all claims as of the date of filing for bankruptcy or the date of plan confirmation, depending on the bankruptcy chapter the debtor files under. *See* 11 U.S.C. §§ 727(b), 1141(d), 1328(a). In most cases, determining whether a debt is discharged is not difficult. If you loan money and the borrower subsequently files for bankruptcy, then the debt is discharged (unless some exception applies). Loan money after a debtor has exited bankruptcy, and the debt is generally collectible despite the discharge.

This determination becomes much more difficult, however, when the debt was contingent but not accrued at the operative lookback period. Under the Ninth Circuit's "fair contemplation" test, "a claim arises when a claimant can fairly or reasonably contemplate the claim's existence even if a cause of action has not yet accrued under nonbankruptcy law." *SNTL Corp. v. Ctr. Ins. Co. (In re SNTL Corp.)*, 571 F.3d 826, 839 (9th Cir. 2009). This rule can create difficulties for a creditor bringing a claim for attorneys' fees that arise out of post-petition litigation, but which are predicated on a pre-petition fee clause. In a somewhat confusing series of cases, the Ninth Circuit has stated that attorneys' fees which arise out of a pre-petition contract are generally considered to be within the "fair contemplation" of the creditor and thus are dischargeable. *Id*. However, the fees are not considered within the "fair contemplation" test in cases where the debtor "'returned to the fray' post-petition by voluntarily and affirmatively acting to commence or resume the litigation with the creditor." *Bechtold v. Gillespie (In re Gillespie)*, 516 B.R. 586, 591 (B.A.P. 9th Cir. 2014); *see also Camelback Constr. v. Castellino Villas, A.K.F. LLC* (*In re Castellino Villas, A.K.F. LLC)*, 836 F.3d 1028, 1034 (9th Cir. 2016). This is a fact-based determination based on a nebulous standard. Accordingly, a creditor lacks the comfort of a bright line rule to determine if their action to enforce a pre-petition attorneys' fees clause violates the discharge injunction.

Previously, the only way for a creditor to ensure that it was not violating the discharge injunction in bringing an action or enforcing a judgment was to file an adversary proceeding in bankruptcy court to determine the scope of the discharge injunction. *See Ruvacalba v. Munoz* (*In re Munoz)*, 287 B.R. 546, 551 (B.A.P. 9th Cir. 2002). While this is the safest course of action, it is not always economically advantageous. The creditor not only must litigate the matter in the non-bankruptcy court to receive the attorneys' fee award (or other monetary award), but also needs to file a separate action in bankruptcy court to confirm the creditor will not violate the discharge injunction by seeking to enforce the award.

In the recent decision of *Lorenzen v. Taggart* (*In re Taggart)*, 888 F.3d 438 (9th Cir. 2018), the Ninth Circuit has provided a path forward to creditors seeking to avoid the risk of such liability without the need for a separate action. In that action, a real estate developer filed for bankruptcy and received a discharge. *Id.* at 440–41. Concurrently, litigation went forward in state court regarding a LLC where the debtor was a partial owner. *Id.* at 440. Judgment was entered against the developer for non-monetary claims and in a post-judgment motion, the creditor sought its attorneys' fees. *Id.* at 441. The creditor requested that the court rule the award was not subject to the discharge injunction, as the debtor "returned to the fray." *Id.* The state court obliged and entered the award of attorneys' fees and ruled that the award was not subject to the discharge injunction. *Id.* at 441–42.

In the Ninth Circuit, a state court may rule on whether a debt is subject to a discharge injunction. *In re Pavelich*, 229 B.R. 777, 783 (B.A.P. 9th Cir. 1999). However, any such finding on the scope of the discharge injunction is subject to collateral attack in bankruptcy court. *Id.* The debtor in *Taggart* took advantage of this and filed a motion in bankruptcy court requesting that the bankruptcy court rule that

(continues on page 10)

California's Successor In Interest Laws No Longer Apply to Reverse Mortgages

By:
Genevieve R. Walser-Jolly, Esq.

By:
Loren W. Coe, Esq.

On May 10, 2018, Senate Bill 1183 passed through the California Legislature and was signed on July 18, 2018 by Governor Brown. Senate Bill 1183 removes reverse mortgages from covered loans under California Civil Code § 2920.7—the California successor-in-interest rule.

The original version of Section 2920.7 "prohibits a mortgage servicer, upon notification that a borrower has died by a person claiming to be a successor in interest, from recording a notice of default until the mortgage servicer gives an opportunity for the claimant to show that he or she is a successor in interest, as specified. Existing law requires a mortgage servicer, within 10 days of a claimant being deemed a successor in interest, to provide the successor in interest with information about the loan, as specified. Existing law also requires a mortgage servicer to allow a successor in interest to assume the deceased borrower's loan or to apply for foreclosure prevention alternatives on an assumable loan, as specified." S.B. 1183, 2018 Cal. Legis. Serv. 136 (Cal. Senate Reg. Sess. 2017-2018).

A reverse mortgage is written for the life of its borrower. When the borrower passes away or otherwise ceases to live in the property, the loan becomes due and payable. Monthly mortgage payments are not made on the reverse mortgage. Instead, interest accrued each month is added to the outstanding loan balance. Lenders therefore consider the borrower's age and life expectancy when determining the available loan amount, keeping in mind that the total loan balance at the time of the borrower's passing should not exceed the property's value. Based on the foregoing, reverse mortgages are non-assumable loans.

The non-assumable nature of reverse mortgages is inherently at odds with the successor-in-interest rules, which permit third parties under certain circumstances to assume deceased borrowers' loans. Allowing a third party—especially a younger person—to assume a reverse mortgage would render the lender's mathematical calculations discussed above obsolete and expose lenders to the risk of being under-secured and losing money.

To remedy this problem, Senate Bill 1183 removes reverse mortgages from the requirements of Section 2920.7. This amendment brings California law into harmony with the federal mortgage servicing rules which expressly exclude reverse mortgages from successor in interest requirements. See 12 C.F.R. § 1024.30(b)(2).

For questions relating to reverse mortgages, please contact Genevieve R. Walser-Jolly at grw@severson.com or Loren Coe at lwc@severson.com.

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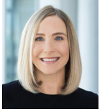
The Preventing Foreclosures on Seniors Act Introduced by Congresswoman Maxine Waters (D-CA)


By:
Genevieve R. Walser-Jolly, Esq.

By:
Katherine Figueroa

In October 2017, Congresswoman Maxine Waters introduced the Preventing Foreclosures on Seniors Act ("PFOSA" or the "Act"), a bill that proposes certain changes to the U.S. Department of Housing and Urban Development's ("HUD") Home Equity Conversion Mortgages ("HECM")[1] program. See Preventing Foreclosures On Seniors Act of 2017, H.R. 4160, 115th Cong. (2017). These changes are largely intended to serve as safeguards against the displacement of surviving non-borrowing spouses. According to Congressman Denny Heck (D-WA), co-sponsor of the bill, the purpose of the PFOSA is to help keep reverse mortgage borrowers [2] and particularly, their surviving non-borrowing spouses, from unfairly losing their homes.

The PFOSA requires mandatory assignment of HECM loans to HUD if there is an eligible non-borrowing spouse living in the home upon death of the borrower. Such assignments by the lender or servicer are currently optional. Once the loan is assigned to HUD, the PFOSA aims to prevent foreclosures on eligible non-borrowing spouses unless basic requirements are not met. The Act aims to accomplish this goal is by requiring that non-borrowing spouses be treated as borrowing spouses for the purposes of loss mitigation and by requiring prompt notice to a surviving non-borrowing spouses of their eligibility to remain in the property.

To enjoy these safeguards, an eligible non-borrowing spouse must be a person who: (1) was legally married to the borrower at the time of loan closing or a person who was in a committed relationship with the borrower at the time of the mortgage origination, and was prevented from marrying the borrower due to their gender, but was then legally married before the death of the borrower;(2) remained married until the borrower's death; (3) currently resides and resided on the property secured by the mortgage as his or her principal residence at the time of origination of the mortgage and throughout the duration of the borrower's life; (4) has obtained or is able to obtain, before the date of foreclosure on the mortgage, a good and marketable title of the property or an ownership interest in the property; and(5) has a legal or other right to remain in the property for life.

The PFOSA will require loss mitigation for HECM borrowers in default. Loss mitigation is currently optional and only offered at the discretion of the lender or servicer. In conjunction with requiring loss mitigation assistance, the PFOSA extends the timeline by which non-borrowing spouses must obtain the paperwork to prove their eligibility. The Act would also grant the Secretary of HUD authority to reduce or deny insurance benefits to any mortgagee who does not comply with these loss mitigation requirements. Lastly, the Act will require HUD to consult with the Consumer Protection Financial Bureau regarding matters of consumer protection to ensure that HUD rules are more sensitive to the issues addressed in the act in the future.

Currently, the bill is supported by the National Consumer Law Center and the California Reinvestment Coalition. However, this bill seems unlikely to pass as President Trump's proposed budget for the 2019 fiscal year cuts HUD's funding by approximately 18.3% from the 2017 enacted level.

Severson & Werson will continue to provide updates on the proposed Act when available.

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[1] HECM loans are reverse mortgages insured by the Federal Housing Administration ("FHA").

[2] Reverse mortgage borrowers are 62 years or older.

"When You Aren't Sure... "
— from page 7

the attorneys' fee award was void as in violation of the discharge injunction. *Taggart*, 888 F.3d at 442. After significant litigation, the bankruptcy court agreed with the debtor and voided the attorneys' fee award. *Id.* The debtor then sought to hold the creditor in contempt for violating the discharge injunction. *Id.*

The bankruptcy court ruled for the debtor and held the creditor in contempt. *Id.* The creditor ultimately appealed to the Ninth Circuit and prevailed. *Id.* at 445. In reaching its decision, the Ninth Circuit reviewed the standard it had set for holding a party in contempt of the discharge injunction. *Id.* at 443. There are two elements for holding a party in contempt: "to justify sanctions, the movant must prove that the creditor (1) knew the discharge injunction was applicable and (2) intended the actions which violated the injunction." *Id*. Unlike most other bankruptcy stays, the first element of knowledge is entirely subjective. Even "an unreasonable belief that the discharge injunction did not apply to a creditor's claims would preclude a finding of contempt." *Id.* at 444.

The Ninth Circuit concluded that, as a matter of law, the creditor was entitled to rely on the state court's incorrect finding that the attorneys' fee award was not subject to the discharge injunction. "[T]he Creditors relied on the state court's judgment that the discharge injunction did not apply to their claim for post-petition attorneys' fees. Although the Creditors . . . were ultimately incorrect, their good faith belief, even if unreasonable, insulated them from a finding of contempt." *Id*.

Going forward, this presents an expeditious option for a creditor who wishes to proceed with an action for money against a bankrupt debtor where it is uncertain if the debt is discharged. Rather than filing a separate and potentially expensive declaratory relief action regarding dischargeability in bankruptcy court, the creditor may proceed against the debtor in non-bankruptcy court, as long as the creditor expressly seeks a ruling from the non-bankruptcy court that the debt is not subject to the discharge injunction. Even if the ruling by the non-bankruptcy court that the debt is not subject to discharge is overturned, liability is precluded under *Taggart*. Accordingly, the creditor is protected from a contempt finding without the need for bringing a separate action in bankruptcy court.

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The Partition Action: Nuances to Beware

By:
Loren Coe

As waves of consumer protection litigation come and go, a steady stream of lawsuits relating to traditional real property issues and title insurance claims persist. In fact, our office has seen a recent increase in the number of claims seeking partition by sale and similar relief—perhaps a result of rising market values. The California Court of Appeal recently published an opinion relating to partition by sale, *Summers v. Superior Court of San Francisco Cty.*, 24 Cal. App. 5th 138 (2018), which illustrates an important pitfall to beware when prosecuting or defending a partition action.

The Court held in *Summers* that a trial court cannot order the sale of property in a partition action before determining the interests of the putative property owners. Tan sued Summers to resolve a dispute about an investment property they jointly owned in San Francisco. The dispute centered around each party's ownership interest in the real property. Tan filed a motion for summary adjudication, requesting "the property be partitioned and sold by private sale," and that the proceeds be held in escrow pending resolution of the parties' respective interest in the property. *Summers*, 24 Cal. App. 4th at 140. Summers opposed the motion, conceding that partition by sale was appropriate but arguing that it was premature since the court had not adjudicated the parties' respective ownership interests in the property. According to Summers, "selling the property before establishing the parties' ownership interests would amount to 'a huge waste' because the sold property would not generate rental income while the parties' ownership interests were litigated." *Id.* at 141. The trial court granted Tan's motion for summary adjudication and ordered the property to be partitioned and sold. Summers appealed.

On appeal, the court reversed. The court relied on the plain language of Cal. Civ. Proc. Code § 872.720(a), which requires an interlocutory judgment in a partition action to include two elements: a determination of the parties' interests in the property and an order granting the partition. Only then can the court order a partition by sale or kind (a physical division) pursuant to § 872.720(b). The trial court's ruling failed to satisfy these elements because it ordered the property to be sold before the parties' interests were resolved.

Another recent matter teaches that partition suits are equally susceptible to disaster even when resolved by settlement rather than judgment. Parties must carefully document settlements in partition actions—whether through a stipulated judgment for partition, a written settlement agreement and/or orally reciting the terms of a settlement on the record. Otherwise, the consequences may be severe. In a recent matter pending in the Orange County Superior Court, a mother (plaintiff) filed an action against her adult son (defendant) for partition by sale of their family home. The parties entered into a settlement and the trial court retained jurisdiction to enforce the terms of the settlement pursuant to Cal. Civ. Proc. Code § 664.6. As stated orally on the record, the settlement required plaintiff to transfer her interest in the property to the defendants in exchange for a promissory note and deed of trust secured against the property. Defendants would then need to sell or refinance the property before the plaintiff's note became due and payable in full the following year, which would pay off the lienholders, including the plaintiff. When defendants refused to execute and deliver the note and deed of trust, plaintiff filed a motion to enforce the settlement agreement. In pertinent part, the motion requested that the Court order the property to be sold. The Court denied the motion because the settlement did not specifically provide for the sale of the property.

The pitfalls exhibited by these cases are avoidable by, for example, closely reading and adhering to the statutes governing partition actions and documenting settlements with precision and foresight. Don't get caught upstream without a paddle!

For questions relating to partition actions, or other real property or title insurance issues, please contact Loren Coe at 949-442-7110 or lwc@severson.com.

2018 Changes to Homeowner Bill of Rights: A Progress Report

By:
Andrew Noble

The California Legislature enacted the Homeowner Bill of Rights ("HBOR") in 2012 to provide protections for homeowners facing non-judicial foreclosure and to modify certain aspects of the foreclosure process. Many (but not all) HBOR statutes sunsetted on January 1, 2018. Of the statutes that sunsetted, many (but not all) were replaced by parallel statutes that became operative the same day. This article highlights the more important changes and how courts and litigators are responding.

Post-Notice of Default Contact

Before January 1, 2018, servicers were required to send a letter to the borrower after they recorded a Notice of Default explaining what loss mitigation options were potentially available and the process by which the borrower could apply for assistance. Cal. Civ. Code § 2923.9 (repealed Jan. 1, 2018). The 2018 HBOR amendments repealed the servicer's obligation to send such a letter to the borrower.

Also, a servicer need no longer send a letter explaining that the borrower may request a copy of the borrower's promissory note and deed of trust, the borrower's recent payment history on the property, or a copy of "any assignment" of the borrower's deed of trust "required to demonstrate the right of the mortgage servicer to foreclose." Cal. Civ. Code § 2923.55(b)(1)(B) (repealed Jan. 1, 2018). The omission will be welcomed by servicers and their attorneys, as it remained unclear until the day the statute was repealed what "assignment" was required to demonstrate a servicer's right to foreclose. A written assignment of deed of trust is not required to be recorded—or even exist—in order to transfer a debt secured by real estate. *Calvo v HSBC Bank*, 199 Cal. App. 4th 118, 123 (2011); *Yvanova v. New Century Mortg. Corp.*, 62 Cal. 4th 919, 927 (2016). The repealed statute caused unnecessary disputes about what servicing contracts and securitization instruments could be responsive.

Dual Tracking

The HBOR prohibition on "dual tracking" means that a servicer may not record a notice of default or notice of trustee's sale, or complete a foreclosure sale, while a complete application is pending. Dual tracking remains prohibited, but the operative language that was formerly contained in § 2923.6 is now, confusingly, divided between § 2923.5(a)(1)(A) (dual tracking with respect to a notice of default) and § 2924.11(a) (dual tracking with respect to a notice of trustee's sale and conducting a sale). As before, a "complete" application means the borrower has provided all documents and information required by the servicer within a reasonable time frame specified by the servicer. Cal. Civ. Code, § 2924.11(f). But there are substantive—and significant—changes as well.

Before, the HBOR prohibited dual tracking only after the servicer had received an application for a "first lien modification." Cal. Civ. Code § 2923.6(c) (repealed Jan. 1, 2018). By inference, a servicer could therefore record a notice of default or notice of trustee's sale, or complete a sale, while in possession of an application for lesser relief such as a temporary forbearance, short sale, or deed in lieu of foreclosure. No longer.

The HBOR now applies to any application for a "foreclosure prevention alternative," which means a first lien loan modification, Cal. Civ. Code § 2924.11(b), or "another available loss mitigation option," Cal. Civ. Code § 2920.5(b). The dual tracking prohibition therefore appears to extend to a forbearance, short sale, deed in lieu of foreclosure, or other relief short of a permanent modification.

Denial Letter

Before the 2018 changes, a denial letter following a servicer's decision not to offer a loan modification was required to comply with detailed and very specific requirements. To comply with the HBOR, the letter had to specify why the investor disallowed the modification (if applicable), or the income and property values if the application was denied due to insufficient net present value ("NPV") along with a statement that the borrower could request the NPV

(continues on page 13)

"2018 Changes..."
— from page 12

inputs. Cal. Civ. Code, § 2923.6(f) (repealed Jan. 1, 2018). The requirements were extensive, but it was clear exactly what was required of servicers. That is no longer the case.

Now, the HBOR requires that the denial letter state "with specificity" the reason for the denial and that the borrower may request unspecified "additional documentation supporting the denial decision" from the servicer. Civ. Code, § 2924.11(b). The vague standard invites litigation.

It is possible that the former notice requirements will establish the level of "specificity" required in describing the reason for denial and the scope of documentation that the borrower may request. But federal Magistrate Judge Laurel Beeler of California's Northern District recently rejected this approach, stating that "the 'Legislature's repeal of a prior statute together with its enactment of a new statute on the same subject . . . with significant differences in language, strongly suggests the Legislature intended to change the law.'" *Jacobik v. Wells Fargo Bank, N.A.*, No. 17-cv-05121-LB, 2018 WL 1184812, at *4, 2018 U.S. LEXIS 37589, at *11 (N.D. Cal. Mar. 7, 2018) (quoting *Goodman v. Lozano*, 47 Cal. 4th 1327, 1337 (2010)). Magistrate Judge Beeler found that the more generalized language employed in the new HBOR statute dispensed with the requirement to provide NPV inputs and other specific data, but she did not opine as to what documentation or information a servicer is required to disclose. *Id.*, 2018 WL 1184812, at *4–5, 2018 U.S. LEXIS 37589, at *11–12.

Right to Appeal

Without question, one of the most significant changes to the HBOR is the loss of the borrower's right to appeal a loan modification decision by explaining to the servicer within 30 days why its determination was in error. Civ. Code, § 2923.6(d) (repealed Jan. 1, 2018); *see Berman v. HSBC Bank USA, N.A.*, 11 Cal. App. 5th 465, 470–75 (2017). The present version of HBOR omits the requirement.

As a result, the HBOR allows a servicer to resume foreclosure proceedings immediately upon providing the written denial. Cal. Civ. Code § 2924.11(a); *see Jacobik*, 2018 WL 1184812, at *5, 2018 U.S. Dist. LEXIS 37589, at 10–12. Before, the dual tracking prohibition prevented a servicer from recording a notice of default or notice of trustee's sale, or proceeding to sale, until after the time to appeal had expired, and if the borrower appealed, until 15 days after the servicer's denial of the appeal. Civ. Code § 2923.6(e) (repealed Jan. 1, 2018).

Repeat Applications

For servicers, a less-welcome change to the HBOR involves the obligation to re-review a borrower who applies for assistance after the servicer denied the borrower. Before, the servicer was not obligated to re-review a borrower unless there was a material change in the borrower's financial condition that the borrower documented and provided to the servicer. Cal. Civ. Code § 2923.6(g) (repealed Jan. 1, 2018). HBOR expressly stated that the purpose was "to minimize the risk of borrowers submitting multiple applications for first lien loan modifications for the purpose of delay." *Id*.

The current version of the HBOR omits this requirement, which appears to be an oversight given the Legislature's demonstrated concern about misuse of the modification process. Strictly speaking, the HBOR does not restrict any number of repeat applications, or even the same application submitted again and again. However, the law does not require idle acts, Cal. Civ. Code § 3532, and the legislative history of the HBOR illustrates that the Legislature sought to avoid improper efforts to delay legitimate foreclosure activity. *See* S. Rules Comm., Office of Senate Floor Analyses, Conf. Rep. No. 1 for A.B. 278 (2011-2012 Sess.) at 29 (June 27, 2012) ("[T]o protect against any potential frivolous claims or efforts to merely delay legitimate foreclosure proceedings, the amendments would provide for enforceability only for certain key provisions related to the prohibitions against dual tracking, SPOC, and false or incomplete documents. Moreover, no legal action whatsoever could be brought unless the violation is material."); S. Rules Comm., Office of Senate Floor Analyses, Conf. Rep. No. 1 for S.B. 900 (2011-2012 Sess.) at 29 (June 27, 2012) (same). Indeed, this is specifically why the Legislature narrowed the borrower's private right of action so that a servicer could only be sued

(continues on page 14)

"2018 Changes..."
— from page 13

to enjoin a "material" statutory violation of select HBOR statutes, as described further below. *Id*. At least one court has specifically rejected the argument that a borrower is entitled to a new loan modification review without showing a material change in his or her financial situation. *Haynish v. Bank of Am., N.A.*, No. 17-cv-01011-HRL, 2018 WL 2445516, at *5, 2018 U.S. Dist. LEXIS 91274, at *14–15 (N.D. Cal. May 31, 2018).

Loss Mitigation Fees

Several HBOR requirements regarding fees charged for loss mitigation services and during loss mitigation review no longer apply. Before, the HBOR prohibited servicers from charging loss mitigation application fees. Cal. Civ. Code § 2924.11(e) (repealed Jan. 1, 2018). The replacement statute does not. Likewise, the HBOR formerly prohibited servicers from charging late fees while an application was under review. Cal. Civ. Code § 2924.11(f) (repealed Jan. 1, 2018). Not anymore.

Penalties and Remedies

The HBOR was and remains highly unusual in the right of action it provides. Before a foreclosure sale has occurred, a borrower is limited to obtaining a preliminary injunction to restrain a "material" violation of four HBOR statutes: § 2923.5 (pre-notice of default contact), § 2923.7 (single point of contact), § 2924.11 (dual tracking), or § 2924.17 (accurate and complete declarations, supported by competent and reliable evidence). The injunction is dissolved when the servicer demonstrates that any violation has been remedied. Cal. Civ. Code § 2924.12(a). Uniquely, a borrower who obtains a preliminary injunction is entitled to his or her attorneys' fees and costs. *Monterossa v. Superior Court*, 237 Cal. App. 4th 747, 754–755 (2015).

If the foreclosure sale has already occurred, the borrower may bring an action for monetary damages incurred from a material violation of the same four statutes, where the lender did not remedy the violation before the sale. The borrower may also recover a statutory penalty of the greater of $50,000 or treble damages if the violation was intentional or reckless. Civ. Code, § 2924.12(b). These remedies remain the same in the current HBOR.

However, the right of California government entities to seek civil penalties against servicers that engaged in repeated violations of § 2924.17 (requiring servicers to review competent and reliable evidence substantiating borrower's default and servicer's right to foreclose) was repealed. Cal. Civ. Code § 2924.17(c) (repealed Jan. 1, 2018).

One as-yet unresolved issue is whether a borrower may bring an action to remedy a violation of an HBOR statute that was repealed after the cause of action accrued. It seems clear that a borrower's pre-foreclosure action should only be brought to enforce the HBOR version currently in effect because the only pre-foreclosure remedy is a preliminary injunction. Injunctions operate prospectively. *Engle v. City of Oroville*, 238 Cal. App. 2d 266, 270 (1965) ("Equity acts in the present tense and not in the past tense."). In cases involving injunctive relief, courts generally apply the then-existing law in effect. *See City of Watsonville v. State Dep't of Health Servs.*, 133 Cal. App. 4th 875, 884 (2005). A court is unlikely to grant a preliminary injunction to enforce a repealed version of HBOR.

It is less clear whether a borrower may bring a post-foreclosure action for damages based upon a violation of a subsequently repealed HBOR statute. Generally, repeal of a statute terminates all claims under that statute, even for alleged violations of the statute that occurred before the repeal. *Beverly Hilton Hotel v. Workers' Comp. Appeal Bd.*, 176 Cal. App. 4th 1597, 1602 (2009); *Younger v. Superior Court*, 21 Cal. 3d 102, 109 (1978); Cal. Gov. Code § 9606. But "[w]hen the Legislature repeals a statute but intends to save the rights of litigants in pending actions, it may accomplish that purpose by including an express saving clause in the repealing act." *Bourquez v. Superior Court*, 156 Cal. App. 4th 1275, 1284 (2007). The HBOR contains no such express saving clause. Magistrate Judge Beeler rejected a borrower's argument that the newly operative HBOR statutes impliedly preserved a right of action that had accrued under a repealed statute. *Jacobik*, 2018 WL 1184812, at *4–5, 2018 U.S. Dist. LEXIS 37589, at *11–12. But the question will continue to be hotly litigated as borrowers and servicers grapple with the effects of the 2018 changes to the HBOR.

The Future of HBOR

(continues on page 15)

“2018 Changes...”
— from page 14

On January 3, 2018—only two days after the changes took place—Senator Jim Beall (D-San Jose) introduced SB-818 to re-enact many of the repealed HBOR statutes and amend others, including restoring the borrower’s right to appeal the servicer’s denial of a loan modification and preventing the servicer from proceeding with foreclosure during the appeal process. The pending legislation would add several requirements not appearing in either version of the HBOR, such as amending the dual tracking prohibition to require that the servicer appoint a single point of contact for the borrower as soon as the borrower requests a foreclosure prevention alternative, rather than upon request for a single point of contact. Interestingly, the proposed legislation includes a saving clause in the form of a statement of legislative intent that any amendment, addition, or repeal of a HBOR statute will not extinguish or change any liability incurred under the statute then in effect. S. Bill No. 818 (2017–2018 Reg. Sess.), §§ 25–26. The legislation was approved by the Senate on May 10, 2018, and is currently before the Assembly Committee on the Judiciary.

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ABOUT THE FIRM

Since its founding over 70 years ago, Severson & Werson has gained a reputation for providing specialized advice, legal services, and expertise to financial institution clients. The services we provide run the gamut from litigation to regulatory matters to client counseling, legislative affairs, and formulating and implementing nationwide strategies for consumer class action defense. The scope of our practice is national, and today the Firm's clients include many of the world's most prominent banks, savings associations, commercial and consumer finance companies, mortgage companies, loan servicers, fin-tech companies, and insurance concerns. The Firm also has one of the West Coast's premier appellate practices in the financial services arena, with a dedicated group of practitioners representing our clients' interests in the California state appellate courts, federal circuit courts, and the United States Supreme Court.

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