

DIRT Periodic Development for Wednesday, August 21, 2013
Heritage Pac. Fin. v. Monroy

Guest Editor: Roger Bernhardt
Professor of Law
Golden Gate University

Fellow Dirters: Below is my most recent column in CEB's California Real Property Law Reporter about the problems a loan collector encountered in not having gotten all of the rights it needed to collect on a defaulted mortgage loan. (Article originally published in the CEB RPLR, July 2013)

DANGEROUS ASSIGNMENTS

Heritage Pac. Fin. v. Monroy

The same appellate panel that delivered a terrifying punch to the residential lending industry a few months ago in *Jolley v Chase Home Fin., LLC* (2013) 213 CA4th 872, reported at 36 CEB RPLR 46 (Mar. 2013) (which is now official, since the supreme court declined to review it), has now given another branch of that industry an equally frightening setback in *Heritage Pac. Fin., LLC v Monroy* (2013) 215 CA4th 972. More fully described on p. 84 of this issue, the case concerned a financial institution (Heritage) whose business model involved buying up defaulted junior mortgages that had already been rendered worthless by senior foreclosures, and then attempting to collect whatever it could from the former mortgagors, even when-as in this case-those mortgages were purchase money loans, and therefore uncollectible because of CCP §580b's one-action rule.

After acquiring Ms. Monroy's mortgage and sending three demand letters to her, Heritage discovered that she had apparently falsified her income on her original loan application and had wrongly represented the purchase as an arm's-length transaction when, in fact, she was buying the house from her son. Emboldened by these discoveries, Heritage wrote Monroy again and also filed a complaint against her for fraud. She responded by cross-complaining that Heritage was violating the California and federal Fair Debt Collection Practices Acts.

After a lot of procedural skirmishing, the trial court sustained Monroy's demurrer to Heritage's complaint and granted summary judgment to her on her cross-complaint, awarding her \$1 in damages but also \$90,000 in attorney fees and costs. All of this was affirmed on appeal.

The published and lengthy appellate decision, although sometimes surprising in its reasoning, gives a good deal of guidance to practitioners-especially those who represent

creditors and their collection arms or cohorts-as to the many dangers lurking in attempts to collect residential debt obligations too energetically.

Careless Handling of Assignments

The main reason that Heritage lost, and the ground that undermined and defeated all of its other theories, was that it was not a proper holder of whatever fraud claims Monroy's original lender (WMC) had against her, because it could not show that those claims had been truly assigned to it by WMC. Even if this were a real liar's loan (*i.e.*, when the borrower had truly, and voluntarily, lied in her loan application), the original lender might well have had a cause of action for fraud, but not the successor holder of the mortgage, to whom no such lies had been told. Heritage's standing was as an assignee, not as a victim.

Heritage had alleged that WMC had also assigned its cause of action for fraud to it, but both the trial court and the court of appeal ruled that its pleading on that issue was insufficient to withstand Monroy's demurrer. Its allegations that WMC had intended to and had in fact "sold the loans and assigned any and all rights ... including [the] fraud claim" action to it were too conclusory to be sufficient. The sale agreement between WMC and Heritage transferring "all right, title and interest in the loan" was no better at demonstrating assignment of a cause of action for fraud. Nor was the endorsement on the note (not quoted in the opinion) apparently any clearer. Heritage had tried to plead its way around the courts' ungenerous reading of the transfer documents by making reference to custom and practice, as well as to language in Monroy's loan application (which said that both the lender and its assigns would be relying on her truthfulness), but those considerations were also held to fail to cure the pleading deficiencies. Even a declaration from an officer of WMC that when it sold loans it also "assigned all of its legal rights in tort as well as contract ... including the right to recover against a borrower for fraud" was not enough to rehabilitate Heritage's incomplete complaint. Finally, the principle underlying CC §1084-that an assignment of a right generally also transfers all other rights incident to it-was held not to connect claims based on fraud in an earlier loan application with claims based on nonpayment of the later assigned promissory note that resulted from the loan application. Therefore, the most that could be said was that Heritage, as an assignee of WMC's claims against Monroy on her note, was not the assignee of its cause of action for fraud allegedly committed by her in obtaining the funds that she owed under the note; those claims apparently still lay with WMC.

Readers may find a lot of this reasoning rather fishy, but displeasure with a judicial rule doesn't entitle the bar to ignore it. The judges may have viewed Heritage Financial as the kind of character who gives the whole industry a bad name, but their holding set forth a rule of law that everyone else must also take into account. Under this new principle of construction, the most generous language imaginable in a blanket

assignment or endorsement will not necessarily transfer all other rights-and those untransferred may be the particular ones that the transferee may find it needs most.

Sometimes, an imperfect transfer can be redeemed by a simple expedient, such as getting another transfer document executed or having the original holder join in the existing proceeding. But more costs are often incurred, even if one is only required to start all over, *e.g.*, the right person is no longer available or will not agree (except for a price) to take the extra steps required, or some deadline has since passed. In some fussier judicial foreclosure jurisdictions, successor lenders who initiated their foreclosures before they had properly crossed all the “t’s” of their previous secondary market transactions were forced to go back to square one and redo every step, rather than being allowed to simply amend their previous work product to correct the slips.

So, if your client is a potential transferee of any right, you had better employ every conceivable noun, verb, and adjective in the transfer documents that you generate to make sure that no obscure or trivial little interest is left behind, even if that ends up making the documents 50 pages rather than 5 pages long.

That strategy may not be necessary if your client is the assignor instead, since an incomplete transfer may be in her best interests, thereby leaving her with some rights that might be valuable or available for a later windfall sale or enforcement. On the other hand, as her lawyer, you might worry whether any reps or warranties she is making in the documents will later require her to put in further (expensive) efforts or pay indemnities when it is discovered that only 99 percent rather than 100 percent was transferred.

If you represent the obligor underlying the assigned transfer, your client is likely not only to be uninvolved in the transfer, but to not even know of it-there aren’t any significant attornment doctrines in mortgage law, so there is probably little precaution to consider at that stage. Maybe your client can even hope that he can successfully claim some kind of third party beneficiary rights enabling him to capitalize on the other side’s mistakes. “Show me the note” may not be entirely dead.

Other Consequences

The failure to effectively transfer the fraud cause of action was only the beginning, not the end, of the story in this case. While Heritage might yet be able to prevail on a fraud claim if it corrects the assignment issue, not having done so when it first asserted its claims against Monroy made it liable to her for violating the federal Fair Debt Collection Practices Act (which apparently would not have been the case if it had taken a proper assignment).

Mortgage foreclosure proceedings are often-although not always-not regarded as debt collection activities, since they seek to enforce a security interest instead, but post-foreclosure proceedings are clearly different, since the property has been sold and only money remains at issue. Since Heritage was attempting to collect money rather than to realize upon now worthless security, it was acting as a debt collector. If Heritage had no right to collect any money from Monroy-because the cause of action on her mortgage note was barred by the antideficiency rules and the cause of action for fraud had not properly been assigned to it-then its wrongful attempts to recover could violate the debt collection acts.

Do such statutes apply to Heritage? Was this residential mortgage a personal, family, or household obligation, since Monroy had claimed in her loan application that she was intending to live in the house (although that may have been another lie)? Was Heritage's complaint exempt because it was a legal document (a complaint) rather than a communication, if it was based on a false claim (because of CCP §580b and the rules regarding assignments)? Was the claim exempt because it was a tort claim, which many cases have held do not fall under the debt collection statutes, or was it still covered because the alleged fraud arose out a consumer transaction? The court's treatment of these issues was as inhospitable to Heritage as its treatment of the assignment issue (and perhaps as dubious), but the lessons to be drawn and the avoidance procedures to follow are not as apparent. Debt collection is dangerous activity and courts are not motivated to be very forgiving. So don't make mistakes. (How is that for helpful advice?)

Heritage Pac. Fin., LLC v Monroy (2013) 215 CA4th 972

Assignee of a promissory note sued Borrower for fraud based on alleged misrepresentations made in Borrower's loan application. Borrower cross-complained against Assignee, alleging violation of the Fair Debt Collection Practices Act (FDCPA) (15 USC §§1692-1692p). The trial court sustained without leave to amend a demurrer against the complaint on the grounds that it failed to state a cause of action for fraud based on assignment. The trial court granted Borrower's motion for summary adjudication on the FDCPA claim. Assignee appealed.

The court of appeal affirmed. The trial court properly sustained the demurrer. The transfer of the promissory note provided Assignee with contract rights; it did not carry with it a transfer of the lender's tort rights. Fraud rights are not, as a matter of law, incidental to the transfer of a promissory note. The complaint did not allege that the assignment transferred the ancillary right of a tort claim, nor did the attached documents support any claim of such an assignment. The transfer of the promissory note did not show a clear intent to assign the assignor's fraud claim.

The allegations also did not show an assignment of the tort claims based on custom and practice. Alleging general custom and practice did not expand the assignment agreement to include ancillary rights not specified. The assignment was silent regarding any tort claim and nothing suggested that it included any rights other than those incidental to the contract rights.

The trial court properly granted Borrower's motion for summary adjudication on the FDCPA claim. Assignee violated the FDCPA when it stated in a letter to Borrower that it had the right to sue her for any misinformation in her loan application.