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In the Matter of Taylor

Guest Editor: Roger Bernhardt
Professor of Law
Golden Gate University

California, like the FTC, prohibits the charging of advance fees for loan modification services. But, whereas the FTC exempts attorneys from that prohibition, California does that opposite, specifically subjecting attorneys to that requirement and threatening to sanction them for violating it. The article below describes how one attorney got into serious trouble for attempting to circumvent the prohibition through "unbundling" his services and collecting for what he hoped were the exempt activities in advance. My comment on the case, from the California Real Property Law Reporter, follow CEB's case description.

In the Matter of Taylor (Cal St Bar Ct, Nov. 9, 2012, No. 10-O-05171) 2012 WL 5489045

In 2009, the California Legislature enacted measures to protect borrowers who seek assistance with mortgage loan modification (Stats 2009, ch 630). They include:

- A requirement for separate notice to borrowers that it is not necessary to use a third party to negotiate a loan modification (CC §2944.6); and
- A bar against collection of fees until all loan modification services are completed (CC §2944.7).

A violation of either provision is cause for imposing attorney discipline (Bus & P C §6106.3) and a misdemeanor (CC §§2944.6(c), 2944.7(b)).

An attorney unbundled his legal advice and real estate consulting services within loan modification cases and collected for each service separately. He charged first for a financial analysis and later for preparation of a lender package, both of which were part of a loan modification.

The State Bar charged the attorney with misconduct involving loan modification cases. The hearing judge found that the attorney charged illegal and unconscionable fees in eight client matters but dismissed moral turpitude charges for fraud and misrepresentation. The hearing judge recommended discipline, including 6 months' actual suspension subject to 3 years' probation and restitution payments. The State Bar sought review, asserting that dismissal of the moral turpitude charges was error and requesting that the attorney be disbarred or that his actual suspension be increased. The attorney did not seek review, but asked to be exonerated on the ground that the case involved fee disputes that should be resolved by fee arbitration.

The State Bar Court found that the attorney collected illegal but not unconscionable fees and that the State Bar failed to prove moral turpitude. It affirmed the hearing judge's recommended discipline but reduced the probation period to 2 years and recommended that Taylor remain suspended until he made full restitution.

Civil Code §2944.7(a) plainly prohibits collection of any fees related to loan modifications until each service contracted for has been completed. The attorney violated §2944.7(a) by charging for the financial analysis before all loan modification services were completed.

The attorney included the statement about the lack of necessity for a third-party negotiator in his retainer agreements. Civil Code §2944.6(a) requires the information to be provided "as a separate statement" but does not require it to be in a separate document. In the one instance in which the attorney charged a client for loan modification services without first sending the client the retainer agreement, he violated §2944.6(a).

THE EDITOR'S TAKE: Attorneys who counted on being able to avoid the prohibitions in CC §2944.7 against collecting in advance for loan modification services by artful drafting of their retainer agreements should abandon that notion. This decision shows how strictly the State Bar is going to enforce the unlimited language of the code section. An attorney who "negotiates, attempts to negotiate, arranges, attempts to arrange, or otherwise offers to perform a mortgage loan modification or other form of mortgage loan forbearance for a fee or other compensation paid by the borrower" may be sanctioned for attempting to "claim, demand, charge, collect, or receive any compensation" before absolutely everything has been completed. Discipline can include license suspension (which can last until all fees have been returned) or worse. Here, the State Bar sought to have the attorney disbarred.

That means that attorneys cannot hope to write one retainer agreement covering a financial analysis of the client's situation and then charging for that step -at least not if they plan on then drafting or submitting a modification proposal to the mortgage lender, with another separate fee charged for that service. That unbundling is not "fully performing each and every service" before receiving "any" compensation, as the section requires.

Any hope that this prohibition would terminate at the end of 2012 was dashed by the section's amendment this year eliminating its scheduled sunset date.

I am glad that I am not out there in practice to have to worry about the scope of this prohibition. Exactly what is and is not allowed when loan modification is a potential consideration? The State Bar's website says that an attorney "who represents a borrower in a civil action against a lending institution" is entitled to accept an offer from the lender to settle the action by modifying the loan, because the law "applies only to employment contracts which are entered into for the purpose of obtaining a loan modification or forbearance for a borrower. If the genuine purpose and goal of an employment contract is to pursue remedies other than a loan modification or forbearance, SB 94 does not apply." But that cannot offer much comfort, since those mitigating statements are "not statutory" language. (No statute said that unbundling was prohibited, either.) Nor, since the web-posed question is limited to cases in which litigation was already underway, will attorneys know what to do when a client, not yet in litigation, comes in to talk about her mortgage difficulties. A rule or distinction that turns on the "genuine purpose" of the employment contract or a fee to be paid now or later could be dangerously slippery. An ordinary ethical (and risk-averse) attorney might well decide to forgo taking on such matters.

If the lending industry had lobbied for a law that effectively prohibited residential borrowers from being able to hire counsel to challenge institutional foreclosure practices, it could not have done better than it did with SB 94. - *Roger Bernhardt*