United Trustees Association

UTA Quarterly

HESCA: Can Your Rights Be Waived?

By Homan Mobasser, Esq., and Eric Ullerich, Esq., Prober & Raphael

This summer, the 9th Circuit Court of Appeals affirmed a District Court's ruling that a general release of Civil Code §1542, did not relinquish a home seller's rescission rights under the California Home Equity Sales Contracts Act ("HESCA", Cal. Civ. Code §1695 et seq.). *Hoffman, et al. v. Lloyd, et al.* 2009 U.S. App. LEXIS 15917.

In the midst of foreclosure, Lloyd sold his home to Hoffman, who then leased it back to him – commonly known as a "sale and leaseback" transaction. As the property was in foreclosure, HESCA applied, which was unfortunate for Hoffman because the sales contract failed to give Lloyd notice of his right to rescind within the time frame described in HESCA.

HESCA's purpose is to "provide each homeowner with information necessary to make an informed and intelligent decision regarding the sale of his or her home to an equity purchaser." Cal. Civ. Code §1695(d)(1). To effectuate its purpose, HESCA obligates a buyer of property that is in foreclosure to provide to the seller, among other things, notice of the seller's right to rescind the sale contract. Cal. Civ. Code §§1695.4-1695.5(d).

Until a buyer adheres to the provisions of HESCA, the seller may cancel the sale contract. Cal. Civ. Code §1695.5(d). Evidencing a strong desire for adherence to HESCA's protections, the California legislature provides that "[a]ny waiver of the provisions of [HESCA] shall be void and unenforceable as contrary to the public policy." Cal. Civ. Code §1695.10.

> "*...a general release of Civil Code §1542, did not relinquish a home seller's rescission rights under the California Home Equity Sales Contracts Act*"

When Lloyd defaulted on his lease payments, Hoffman filed an unlawful detainer action. The parties settled the unlawful detainer and as part of the settlement, Hoffman and Lloyd executed a mutual release agreement, which expressly waived the protections of Cal. Civil Code §1542, but made no mention of HESCA.

Back on an even keel, the lure of rough seas could not be resisted. Within months, Lloyd filed a Chapter 11 bankruptcy and on October 18, 2004, recorded a notice of rescission of the original sale agreement. Not one to take an offence lying down, Hoffman filed a state court suit seeking cancellation of the rescission, which was sucked into the drain of Lloyd's bankruptcy.

After conducting an evidentiary hearing and determining as a matter of fact that Lloyd was unaware of his HESCA rights

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at the time of release, the bankruptcy court concluded that the general release did not apply to Lloyd's rights under HESCA. Because the right to rescind survives until compliance, Lloyd's rescission was, therefore, valid.

The district court affirmed but did not believe an evidentiary hearing was even necessary. The original sale did not comply with HESCA and the settlement did not waive any right under HESCA, Hoffman had no evidence to the contrary, and, thus, Lloyd's rescission was valid. Circuit Judge Schroeder's observation that HESCA's right to rescission cannot be waived suggests that the court may not have even needed to go that far.

How could the buyer have avoided this situation? Rather simply, by following the instructions of §1695.5 at the original sale, which conveniently provides the appropriate wording, location and point size for the waiver (in bold, of course).

Once, the lease-back was concluded, could Hoffman have salvaged the contract in the settlement of the unlawful detainer? Maybe, if the settlement included the specific notices from HESCA along with recitals that the parties had consulted with counsel and understood their rights and that the right to rescind was being given up. To the contrary, if it got up to the circuit court it was likely beyond salvation. Circuit Judge Schroeder never had to decide whether a knowing waiver of HESCA rights would have been valid but the fact that he cited its provision that "[a]ny waiver of the provisions of [HESCA] shall be void and unenforceable as contrary to the public policy," in the third paragraph of his opinion calls any waiver into question. His closing comments, while citing the lower court, are illustrative, "Any contrary result would undermine HESCA by permitting a purchaser to defeat the seller's right to rescind by first executing a sale contract without the required notices, and then executing a release purporting to extinguish any known and unknown claims....[t]his kind of backdoor loophole is inequitable and frustrates the purposes of HESCA."

Obviously, this case is a cautionary tale for real estate investors. Home equity purchasers are expected to be sophisticated. Buyers purchasing a property for their personal residence are specifically excepted from HESCA. Cal. Civil Code §1695.1(a)(1). Real estate investors should take this to heart as even more HESCA litigation can be reasonably anticipated especially if the subprime meltdown extends into the prime market. But this case goes beyond HESCA and belies a judicial enmity to general waivers. Do not expect the courts to be kind to a general waiver of "important statutory rights." In this case it was HESCA but consider the similar treatment of the Federal Truth-in-Lending Act in *Mills v. Home Equity Group, Inc.*, 871 F. Supp. 1482 (D.D.C. 1994).

No lawyer is going to delete his or her general waivers but the drafter should know that a §1542 waiver will be construed as narrowly as possible and when it comes up against a statute like HESCA it will almost certainly fail. And if you can expect a narrow reading from a state court judge just wait until it ends up before a bankruptcy judge.

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Featured Article

FDCPA: The Hidden Danger of Inviting Debtors to "Please Call"

By Homan Mobasser, Esq., and Eitan Yehoshua, Esq., Prober & Raphael

This winter, the United States Court of Appeals for the Third Circuit Court ("Court of Appeals") vacated a New Jersey District Court's ruling which granted Health Care Recovery Group, LLC's ("HRRG") motion for judgment on the pleadings in a case filed by Ray V. Caprio ("Caprio") against HRRG for Fair Debt Collection Practices Act ("FDCPA") violations.

Caprio, who is defined as a debtor by the FDCPA, filed a complaint against HRRG claiming that HRRG's one page, double sided collection letter sent to Caprio violated 15 U.S.C. §1692(g) and 15 U.S.C. §1692e(10) because the letter included the following sentence: "If we can answer any questions, or if you feel you do not owe this amount, **please call** us toll free at **800-984-9115** or write to us at the above address." HRRG's letter to Caprio also included HRRG's telephone number in an even larger font within the letterhead at the top of the collection letter, while HRRG's mailing address only appeared in the letterhead in a smaller print than the telephone number. The reverse side of HRRG's letter included the special notice disclosures required in every collection letter sent by a debt collector pursuant to 15 U.S.C. §1692(g). Caprio argued the language in HRRG's collection letter misrepresented that Caprio could either call or write to HRRG to dispute the alleged debt, when in reality, the FDCPA requires a debtor to dispute the alleged debt in writing.

The question before the Court of Appeals was a question of law: Does the language in HRRG's collection letter "contradict or overshadow" the FDCPA validation notice? The position taken by the Court of Appeals was clear: to eliminate abusive debt collection practices, a debt collector's collection letter will undergo strict scrutiny to ensure that even the "least sophisticated debtor" can discern his or her rights under the FDCPA. Furthermore, the Court took the position that the contents of the letter cannot "overshadow or contradict" the accompanying disclosure of the debtor's right to dispute the debt. The "statutory notice must not only explicate a debtor's rights; it must do so effectively." *Graziano v. Harrison*, 950 F.2d 107, 112 (3d Cir. 1991).

> *"Furthermore, the Court took the position that the contents of the letter cannot "overshadow or contradict" the accompanying disclosure of the debtor's right to dispute the debt."*

Amongst other things, 15 U.S.C. §1692(g) requires a debt collector to disclose the following to the debtor: (1) the amount of the debt; (2) the name of the creditor to whom the debt is owed to; (3) a statement that unless the debtor, within 30 days after receipt of the collection letter, disputes the validity of the debt, the debt will be assumed to be valid by the debt collector; (4) a statement that if the debtor notifies the debt collector **in writing** within the 30 day period that the debt is disputed, the debt collector will provide a verification of the debt; and (5) a statement that upon the debtor's **written** request within the 30 day period, the debt collector will provide the debtor the name and address of the original creditor. 15 U.S.C. §1692e(10) restricts a debt collector from utilizing "false, deceptive or misleading representation" in connection with the collection of any debt.

In making its decision, the Court of Appeals yielded to the public policy behind the FDCPA regulations. The Court noted that the FDCPA must be broadly construed in order to give full effect of its purpose to (1) protect the "least sophisticated debtor" from "abusive debt collection practices, which contribute to the number of personal bankruptcies, marital instability, loss of employment, and invasion of privacy"; and (2) to insure

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that those debt collectors who refrain from using such practices are not competitively disadvantaged. In making its ruling, the Court made it clear that the "least sophisticated debtor" includes the "gullible as well as the shrewd," however, the FDCPA does not provide protection for the willfully blind or non-observant. *Lesher v. Law Offices of Mitchell N. Kay, PC*, 650 F.3d 993, 997 (3d Cir. 2011)

The Court applied law from two previous cases to examine both the form and content of HRRG's letter to Caprio in determining whether HRRG's letter "contradicted or overshadowed" the remaining validation notice included in the letter. The Court acknowledged that the FDCPA disclosure notice on the reverse side of HRRG's letter did accurately provide the correct disclosures to Caprio; however, the Court held that the contents of the letter could be reasonably read to have two or more different meanings thus confusing a less sophisticated consumer. Moreover, the Court reasoned that the "least sophisticated debtor" could reasonably believe that he could effectively dispute the validity of the debt by calling HRRG, despite the fact that 15 U.S.C. §1692(g) requires such disputes be made in writing.

The Court further held that the form of HRRG's letter to Caprio overshadowed the remaining contents of HRRG's letter since the words "please call" and HRRG's phone number were in bold, while in contrast, the words "write us at the above address" were not in bold. Moreover, the Court determined that inclusion of HRRG's telephone number in an even larger font within the letterhead, while HRRG's mailing address only appeared in the letterhead in a smaller print than the telephone number could confuse debtors. Accordingly, the Court held that the "least sophisticated debtor" would take the easier route in calling HRRG to dispute the validity of the debt instead of going through the trouble of drafting and mailing a written dispute of the debt. After examining both the form and content of HRRG's letter, the Court concluded that the contents of HRRG's letter contradicted and overshadowed the validation notice, as Caprio, the "least sophisticated debtor," would be uncertain of his rights under the FDCPA.

The Court ultimately held in Caprio's favor and remanded the case to the District Court for further proceedings. Since the Court remanded the case based on Caprio's 15 U.S.C. §1692g claim, the Court found that the case must also be remanded based on Caprio's 15 U.S.C. §1692e(10) claim as well. This case should serve as an example for all creditors to be very accurate in drafting letters to debtors, especially when inviting debtors to call. Not only do creditors have to provide, in writing, all of the debtor's rights under 15 U.S.C. §1692(g), but creditors should also be careful that the form and remaining content of the collection letter does not contradict nor overshadow the debtor's rights. All creditors should draft such correspondence while taking into consideration the broad interpretations of the FDCPA by the courts and the amount of protection the FDCPA provides all consumers, including "the gullible as well as the shrewd."

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Eviction, California-Style

Changes to California law will require new strategies for dealing with post-foreclosure evictions.

by Dean Prober & Homan Mobasser

In order to reduce the impact of foreclosures on the California economy and provide some stability with respect to residential housing, the state government and municipalities have enacted legislation to allow both former homeowners and tenants renting from those homeowners to extend the time that they may remain in possession of their property and, in some cases, even allow them to remain in possession indefinitely. Needless to say, California's post-foreclosure eviction practice requires new strategies for navigating the various statutes and tactics employed by former owners and tenants.

The process by which the owner of real property obtains possession of real property after the termination of the tenancy is called unlawful detainer. California Code of Civil Procedure Section 1161a specifically deals with obtaining possession of property after a foreclosure.

It is important to understand that while California unlawful detainer practice is not overly complicated, attention to detail is exceedingly important. The slightest error or mistake may be fatal to the lender's attempt to obtain possession of the property. Because unlawful detainer law involves the forfeiture of someone's right to possession, court's strictly construe the statutory procedures that regulate it and require strict compliance with those procedures.

Before an action for unlawful detainer may be filed, the owner of the property is required to serve a Notice to Quit upon the occupants of the property. Depending upon the jurisdiction, the notices served upon the occupants of the property must include specific information, provide a specific number of days to vacate the property and must be served in a manner proscribed by law. If the contents and/or service of the notice have errors, then the court may dismiss the subsequently filed unlawful detainer action and rule in favor of the occupant.

Prior to the recent economic crisis, California law required an owner of the property to serve a three-day Notice to Quit for post-foreclosure evictions involving a previous borrower of the property, and a 30-day Notice to Quit for tenants of the former owner of the property residing in the foreclosed property. However, with the enactment of California Senate Bill 1137, California law requires a 60-day Notice to Quit for tenant-occupied property that was foreclosed upon. As of this writing, the legislation remains in effect until Jan. 1, 2013.

PTFA'd off

In addition to the changes made to California law, there is also the federal Protecting Tenants at Foreclosure Act (PTFA) of 2009, which provides post-foreclosure tenants with a multitude of protections. Because the PTFA is federal legislation, it supersedes any state or local legislation by virtue of the Supremacy Clause of the U.S. The PTFA was originally set to expire Dec. 31 of this year, but the Dodd-Frank Act extended it to Dec. 31, 2014.

Under the PTFA, the immediate successor in interest of a dwelling or residential real property must provide tenants with a 90-day Notice to Quit after the property is sold at foreclosure. However, if the tenant has a "bona fide" lease that has not expired, the tenant is permitted to reside in the property until the end of the lease term and can thereafter be evicted only after service and the expiration of the 90-day Notice to Quit. This protection has caused a number of tenants to claim leases or rental agreements that contain less-than-market rates of rent, typically for long periods of time.

However, the PTFA requires that the "bona fide" lease be the product of an arm's length transaction and that the rent amount under the lease not be "substantially" less-than-fair market rent for the same or similar property. The courts have not defined "substantially less-than-market value," and this has enabled many tenants to take advantage of the PTFA at the lender's expense.

In order to combat this tactic, lenders should consider contesting the legitimacy of these leases by filing the unlawful detainer action. Even if the lender is not successful outright, it may result in stipulated resolution by which the lender may obtain possession of the property at the agreed upon date.

Rent control ordinances

Notwithstanding the federal and state changes to the law, tenants are also protected by local rent control and "just

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cause" eviction ordinances implemented to specifically protect tenants in occupying properties after a foreclosure sale. In the past, many of these local rent control and "just cause" eviction ordinances were not applicable to single family residences, as these ordinances were originally designed to protect tenants in residing in multi-unit buildings under traditional landlord tenant relationships - not single-family residences.

For example, on Dec. 17, 2008, Los Angeles passed Ordinance No. 180441, which afforded tenants protections of the "just cause" eviction portion of the Los Angeles Rent Stabilization Ordinance when a property is foreclosed upon and occupied by a tenant, regardless of whether the property is a single-family residence or unit in a multi-unit apartment building. The ordinance has created havoc for lenders and property investors because it creates an almost "bullet proof" vest for tenants, shielding them from having to give up possession of the property.

However, despite these protections, the lender may still be able to obtain possession of the property if the tenant has not paid the rent. In such cases, the lender proceeds on the basis of the non-payment of rent instead of the foreclosure. Our firm has had frequent success using this strategy.

Moreover, lenders can also obtain possession of the property by simply paying the tenants to vacate the property. Most rent control ordinances make provision for relocation of the tenants. Be warned that this option is often quite costly: relocation costs under these ordinances can range anywhere between $5,000 and $17,500, are fixed by statute and are not related to the actual cost of relocating the tenant.

Prolonging possession

Needless to say, some individuals seek to prolong their ability to stay in possession of property. One of the most common ways to delay eviction is the filing of a bankruptcy by the occupants of the property. This results in an automatic stay and virtual injunction of the unlawful detainer. Lenders in this situation must immediately seek to obtain relief from the automatic stay.

Former owners of the property facing eviction from the property commonly use a tactic involving the filing of a lawsuit against the lender, claiming the lender wrongfully foreclosed upon the property. Once filed, they attempt to consolidate the unlawful detainer action with the wrongful foreclosure action. If successful, the eviction action may be stayed - pending the outcome of the borrower's lawsuit - resulting in the previous borrower and/or their tenants staying in the property until the wrongful foreclosure action is litigated.

In order to combat this tactic, lenders should aggressively oppose these suits as well as the attempts to consolidate the civil suits with the unlawful detainers. Aggressive opposition to these cases more often than not results in the lender obtaining possession of the property in a shorter period of time. Moreover, once the lender obtains possession of the property, the occupants generally abandon their lawsuits.

A more recent tactic employed by both former owners and tenants to prolong possession of the property is the "removal" of the unlawful detainer suit from the state court to federal court. While the federal court generally does not have jurisdiction in these cases, the person seeking to remove these cases are hoping to buy additional time.

The federal court is often proactive in "remanding" (sending back) these cases to the state court, but in some instances, they do not. In these cases, counsel for the lender must file a "Motion to Remand" the suit back to the state court.

The protections provided to occupants of post-foreclosure properties has resulted in both the length of time of possession of properties as well as the tactics employed by the property's occupants to prolong possession further. Lenders can significantly impact the process by aggressively opposing these tactics. SM

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