

NEW RESIDENTIAL MORTGAGE MODIFICATIONS REQUIRE LEGAL FORMALITIES

BY MATTHEW I. KAPLAN

The California Court of Appeal for the Fourth Appellate District recently clarified the steps required to ensure enforceability of residential home mortgage modifications and forbearance agreements. In *Secrest v. Security National Mortgage Loan Trust 2002-2*, the Court of Appeal applied the Statute of Frauds to invalidate a forbearance agreement and let the holder of a mortgage foreclose.

In 1996, GE Capital Mortgage Services, Inc. loaned Luther and Charmella Secrest \$552,700 to buy a home in Orange County, California. Like virtually all home loans in California, the Secrests' loan was evidenced by a promissory note that was secured by a deed of trust on the property. By 1998, the Secrests had fallen behind in their loan payments and the loan had gone into default. Nevertheless, GE Capital was able to sell the loan on the secondary market in 1999. With the sale of the loan, GE Capital transferred the promissory note and deed of trust to the purchaser, Ocwen Federal Bank, FSB.

Ocwen worked with the Secrests to get their loan payments back on track and avoid foreclosure. In April 2001, they had worked out the details of an agreement that would let the Secrests stay in their home and make catch-up payments to become current on the loan. This forbearance agreement was put in writing and was signed by both the Secrests and Ocwen. It required the Secrests to pay a \$15,000 downpayment on the full loan reinstatement amount and provided for an increased monthly loan payment to cover the balance of the loan reinstatement amount and original monthly loan charges.

By January 2002, the Secrests were once again in default on their loan. Ocwen renewed discussions with them on ways they could get current on their loan obligations and they discussed the parameters

of another forbearance agreement. On January 18, 2002, Ocwen sent a proposed unsigned forbearance agreement to the Secrests which also provided for payment of the loan reinstatement amount by a down payment and monthly payments to cover both the reinstatement amount and original loan balance. Noticing several errors in the draft forbearance agreement, Mr. Secrest telephoned Ocwen.

During the phone call, the parties agreed that the Secrests would sign and return the forbearance agreement after making a number of handwritten corrections, including crossing out the loan reinstatement amount which had to be recalculated by the bank. They also agreed that the Secrests would wire-transfer a \$13,422.51 downpayment on the new forbearance agreement to Ocwen, and that Ocwen would prepare a corrected forbearance agreement that included the proper reinstatement amount. The Secrests wire-transferred the downpayment but Ocwen did not return a corrected forbearance agreement. Thereafter, Ocwen resold the note and mortgage and the Secrests defaulted on the loan.

In September 2004, the current note holders, Security National Mortgage Loan Trust 2002-2, JP Morgan Chase Bank and SN Servicing Corporation issued a notice of default and election to sell the property at a foreclosure sale. The Secrests filed a lawsuit seeking to stop the foreclosure sale based on the second, unsigned forbearance agreement with which they claimed they were in compliance. The Court of Appeal affirmed the judgment of the trial court, ruling that the unsigned forbearance agreement was unenforceable under the statute of frauds.

California's statute of frauds is codified at Civil Code section 1624. Contracts falling under the statute of frauds are unenforceable "unless they, or some note or memorandum thereof, are in writing

and subscribed by the party to be charged or the party's agent." Civil Code section 2922 clarifies that the creation, renewal or extension of a mortgage and/or a deed of trust must also be in writing and in full compliance with the statute of frauds.

However, as the Court of Appeal observed, the purported forbearance agreement "does not create, renew, or extend a deed of trust." Thus, the question presented was whether a contract modifying a contract covered by the statute of frauds (such as the alleged forbearance agreement) also fell under the statute of frauds. The Court of Appeal concluded that it did based on Civil Code section 1698(a) (which states that a contract in writing can be modified by a contract in writing) and the terms of the note, deed of trust and purported forbearance agreement.

Specifically, the Court of Appeal relied on the language of the deed of trust itself, which stated that it would apply to all "modifications of the Note." It also recognized that the purported forbearance agreement fell within the statute of frauds because it "serves as evidence of the debt secured by the deed of trust" since it would modify the underlying loan by providing a new monthly payment and limitation on right to foreclose.

Significantly, the conclusion that a forbearance agreement must be in writing conflicts with one of California's leading real estate treatises, Miller & Starr: California Real Estate (3d Ed. 2003) Vol. 4, § 10:123. Miller & Starr reason that an unwritten forbearance agreement supported by consideration should be enforceable, citing *Cornelison v. Kornbluth*, 15 CA.3d 590, 596-597 (1975). However, the *Secrest* court points out that the cited pages of *Cornelison* do not even address forbearance agreements. Instead, it addresses whether the purchaser of property secured by a deed of trust is personally liable for the debt secured by the deed of trust. *Cornelison* explains that under the statute of frauds, the purchaser has no personal liability unless he or she signed a writing assuming the debt or assumption of the debt was specifically

provided for in the deed effectuating the transfer of the property. Id.

The clear lesson of *Secrest* is to assure that any transaction involving real estate or real estate financing is in writing, signed by both parties.

The opinion was issued on October 9, 2008 by the California Court of Appeal for the Fourth Appellate District in the case entitled *Secrest v. Security National Mortgage Loan Trust 2002-2*, ___ Cal.Rptr.3d ___, 2008 WL 4516413 (Cal.App. 4 Dist.).

MATTHEW I. KAPLAN is Counsel in the Los Angeles hallway of Tucker Ellis & West LLP, a law firm with extensive experience representing financial institutions from its offices in California and Ohio. Mr. Kaplan's practice focuses on business and commercial litigation.

For more information, please contact:

Matthew Kaplan 213.430.3309
mkaplan@tuckerellis.com

515 South Flower Street
Forty Second Floor
Los Angeles, CA 90071

www.tuckerellis.com

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