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Newsletters

Consumer & Class Action Litigation Newsletter - March 2015

March 23, 2015

Illinois Supreme Court Provides Significant Victory to Consumer Financial Services Industry

The Illinois Supreme Court recently held that the judgment in a collection lawsuit is not void even if the plaintiff was an unlicensed debt buyer when it filed the lawsuit. *LVNV Funding, LLC v. Trice*, 2015 IL 116129, ¶49 (2015). The facts of this case were somewhat unique, but the ruling should benefit debt buyers, debt collectors, and collection attorneys, as well as mortgage servicers. Hinshaw & Culbertson LLP represented LVNV in the appeal.

Plaintiff in *Trice* was a debt buyer that filed a breach of contract lawsuit against a consumer/debtor in January 2008. The debtor admitted that he owed the money but refused to pay, claiming it was for a home renovation he thought was done poorly. The trial court judge entered judgment on behalf of the debt buyer. Thereafter, the debtor moved to vacate the judgment, arguing it was void because the Illinois Collection Agency Act (ICAA) required the debt buyer to have a license before it filed suit.

Many states in the past decade have passed laws to regulate the debt buying industry. Effective January 1, 2008, the Illinois legislature made some subtle revisions to the ICAA. In the motion to vacate the judgment, Trice argued that the 2008 amendment required debt buyers to obtain a license under the ICAA. The trial court, however, denied the motion, holding that the debtor waived defense based on the lack of license by not raising it prior to the judgment being entered.

In 2011, the Illinois appellate court reversed the trial court decision. It held that if the debt buyer-plaintiff needed a license under the ICAA, then the judgment should be declared *per se* void as the plaintiff committed a crime under the ICAA. The court, though, agreed to remand the case for further discovery on the licensing issue.

Attorneys

John P. Ryan

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On remand, the debt buyer argued the judgment should not be vacated or void. Further, it argued the 2008 ICAA was unconstitutional. The trial court held that the ICAA licensing amendment was unconstitutional because its criminal penalty provisions violated equal protection and due process. The case then went directly to the Illinois Supreme Court because a law was held unconstitutional.

While these proceedings were going on from 2011 to 2014 and as a consequence of the appellate court ruling, numerous class actions were filed in Illinois against debt buyers and collection lawyers for collection activities by or for unlicensed entities. Moreover, defendants in foreclosure actions began to argue that foreclosure judgments were void because the plaintiff- mortgage servicer failed to have a license under either the ICAA or the Illinois Residential Mortgage License Act. Similar litigation has been filed in other states.

On February 27, 2015, the Illinois Supreme Court held that the appellate court's 2011 ruling was wrong and that the trial court was correct when it initially denied the debtor's motion to vacate the judgment. The Court determined that the trial court had both subject matter and personal jurisdiction in the original collection case and, thus, the judgment was not void.

The ruling means that judgments entered for an unlicensed plaintiff cannot be attacked at any time based on the judgment being void. It also means that a trial court can deem a possible license defense waived if the debtor fails to raise it prior to the judgment being entered.

For more information, please contact John P. Ryan.

Fourth Circuit Court of Appeals Applies the Doctrine of *Res Judicata* to Bar an FDCPA Suit Based on the Filing of an Alleged Invalid Proof of Claim

Covert v. LVNV Funding, LLC, 2015 WL 877133 (4th Cir. Mar. 3, 2015)

The Fourth Circuit, in *Covert*, analyzed whether the statutory claims of five (5) debtors (Debtors) brought against an unsecured creditor subsequent to the confirmations of their Chapter 13 bankruptcy plans, were subject to the doctrine of *res judicata*. The Court held that the prior confirmations of the debtors' bankruptcy plans were final judgments on the merits. Further, the Debtors and the unsecured creditor were parties to the Chapter 13 plan confirmations proceedings, and Debtors had the opportunity to raise the statutory claims raised in the current action in the prior bankruptcy proceeding. As such, Debtors' statutory claims were subject to the principles of *res judicata* and were thus precluded by the confirmation of the Chapter 13 plans.

In *Covert*, the Debtors each separately filed petitions for individual Chapter 13 bankruptcy. LVNV Funding, LLC and its affiliates (LVNV) filed proofs of its unsecured claims in each bankruptcy proceeding. Each Chapter 13 plan was approved and Debtors subsequently made payments on LVNV's claims. At all relevant times, LVNV was not licensed to do business as a debt collection agency in Maryland. In March 2013, Debtors filed this punitive class action lawsuit alleging LVNV had violated the Fair Debt Collections Practices Act (FDCPA) and various Maryland laws by filing its proofs of claim without a Maryland debt collection license. LVNV moved to dismiss all claims for failure to state a claim upon which relief could be granted (Motion). The District Court granted the Motion, finding the state common law claims were barred by *res judicata* and the federal and state statutory claims failed to state a claim because filing a proof of claim does not constitute an act to collect a debt. The Debtors appealed.

The Fourth Circuit affirmed the dismissal on all claims solely on *res judicata* grounds. It found

> "that a prior bankruptcy judgment has *res judicata* effect on future litigation when the following three conditions are met: (1) the prior judgment was final and on the merits, and rendered by a court of competent jurisdiction in accordance with the requirements of due process; (2) the parties are identical, or in privity, in the two actions; and (3) the claims in the second matter are based upon the same cause of action involved in the earlier proceeding."

The Fourth Circuit held all three of these requirements were met in the instant matter. The Court explained, "to hold that proofs of claim are subject to post-confirmation challenge…would risk undermining [the purpose of a bankruptcy proceeding] by creating an incentive for debtors to enrich themselves at the expense of their creditors." Accordingly, allowing post-confirmation collateral attacks on a bankruptcy plan's terms would "destroy the finality that bankruptcy confirmation is intended to provide." Therefore, Debtors' statutory claims were barred and dismissed based on the

doctrine of *res judicata*.

For more information, please contact Your Hinshaw Attorney.

Massachusetts Mortgage Law Continued to Evolve In 2014

Once again, 2014 was an active year for new decisions in the area of mortgage servicing in Massachusetts. Most significantly, the Massachusetts Supreme Judicial Court took on the thorny issue of right-to-cure notices, and the Massachusetts Appeals Court clarified the instances in which a mortgage borrower has standing to challenge assignments of her mortgage after closing. In addition to those high-profile decisions, several other decisions are likely to have a significant effect on Massachusetts mortgage-servicing law. This article is a summary of the most significant mortgage-servicing decisions of 2014.

Right-To-Cure Notices

Much of the recent litigation has focused on alleged defects in notices of the borrower's default. Standard-form mortgages in Massachusetts require that the mortgagee provide a 30-day notice of the borrower's right to cure a default before accelerating the debt secured by the mortgage. The standard mortgage requires that the right-to-cure notice contain certain basic information regarding how the borrower can cure a default. In 2007, Massachusetts enacted M.G.L. c. 244, Section 35A, a statute that now requires that mortgagees provide a 150-day cure period and greatly expands the scope of information that must be contained in the right-to-cure notice.

Section 35A's enactment led to litigation over whether a given right-to-cure notice complied with the technical disclosure requirements of the statute. In eviction cases and elsewhere, defaulted borrowers took the position that even a technical defect in the right-to-cure notice would invalidate the foreclosure sale, requiring the mortgagee to restart the foreclosure process. Many courts agreed with this position. For example, in *Bravo-Buenrostro v. OneWest Bank F.S.B.*, No. SUCV2011-03961, (Mass. Super. Ct. May 31, 2011), the Superior Court ruled that a foreclosure sale was void as a result of the lender's misidentification of the mortgage servicer as the "mortgagee" when, in fact, the mortgagee was Mortgage Electronic Registration Systems, Inc. (MERS). Many other courts took this same approach of requiring strict compliance with Section 35A's disclosure requirements.

This year, the Supreme Judicial Court clarified that Section 35A is not a foreclosure statute and a mere technical defect in a right-to-cure notice would not invalidate a foreclosure sale. *U.S. Bank, National Association v. Schumacher*, 467 Mass 421 (2014). In spite of providing some much-needed clarity, the Supreme Judicial Court 's decision did not end litigation over right-to-cure notices. Justice Gants's concurrence in *Schumacher* predicted that in order to reverse a foreclosure sale in a post-foreclosure summary process case based on an allegedly defective right-to-cure notice, a borrower would have to prove that "the violation of § 35A rendered the foreclosure so fundamentally unfair that she is entitled to affirmative equitable relief." *Id.* at 433 (Gants, J.). Though it was not the majority's opinion, many courts have adopted the "fundamental unfairness" standard of the Gants concurrence as the standard in evaluating allegedly defective right-to-cure notices.

Thus far, the only appellate decision to interpret *Schumacher* is *Haskins v. Deutsche Bank Nat. Trust Co.*, 86 Mass. App. Ct. 632 (2014). Unlike *Schumacher*, *Haskins* involved a pre-foreclosure challenge to a foreclosure sale. The Massachusetts Appeals Court ruled that the "fundamental unfairness" standard should not apply in the pre-foreclosure context, although it did not adopt a different standard. *Haskins*, 86 Mass. App. Ct. 632 n. 11. *Haskins* also holds that a right-to-cure notice that identifies the mortgage servicer as the "mortgagee" complies with Section 35A. *Id.* at 462. This is because the purpose of Section 35A is to provide information that would allow the borrower to cure a default. *Id.* Identifying the mortgage servicer to whom payment should be made serves that purpose. *Id.*

The *Schumacher* and *Haskins* decisions shifted the focus of litigation over right-to-cure notices, but most certainly did not end it. Technical defects in right-to-cure notices will no longer result in an automatic, after-the-fact reversal of a foreclosure sale. However, *Schumacher's* "fundamentally unfair" standard creates a potential issue of fact that may require extensive discovery and even a trial. Conversely, the *Haskins* decision suggests that courts should apply a different, perhaps lower, standard where the borrower challenges the notice before the foreclosure sale.

Mortgage Assignments

In 2014, the Massachusetts appeals courts took on the question of when mortgage borrowers have standing to challenge an assignment of their mortgages. In the securitization process, the mortgage-loan originator often assigns the mortgage one or more times as the rights to the mortgage are sold on the secondary market. This issue became important after the Supreme Judicial Court ruled in *U.S. Bank Nat. Ass'n v. Ibanez*, 458 Mass. 637, 649 (2011) that the foreclosing entity must hold title to the mortgage before advertising the sale of the property. In *Culhane v. Aurora Loan Servs. of Nebraska*, 708 F.3d 282, 291 (1st Cir. 2013), the First Circuit ruled that mortgage borrowers only had standing to challenge mortgage assignments that were wholly void, not ones that were merely voidable at the election of one of the parties.

In 2014, the First Circuit significantly clarified the void/voidable distinction in *Wilson v. HSBC Mortgage Servs., Inc.*, 744 F.3d 1, 9 (1st Cir. 2014). In *Wilson*, the First Circuit clarified that a "voidable" assignment is one that is "injurious to the rights of one party, which he may avoid at his election." *Id.* at 9. It listed various examples of voidable assignments: those that were entered into under duress, induced by fraudulent misrepresentations, the result of a mutual mistake, or executed by a corporate officer exceeding his authority. *Id.* at 9-10. It also provided examples of void contracts: those that are void for violating public policy or those where the purported assignor had nothing to assign in the first place. *Id.* at 10. Ultimately, *Wilson* holds that an individual who purports to be an officer of both the assignor and the assignee of the mortgage may execute an assignment. The allegation that the signing officer "wore multiple hats" would not make the assignment void or subject to challenge by the borrower. *Id.* at 11.

In 2014, the Massachusetts state appellate courts considered the issue of mortgage-borrower standing to challenge mortgage assignments for the first time. In *Sullivan v. Kondaur Capital Corp.*, 85 Mass. App. Ct. 202, 206 n. 8 *review denied*, 469 Mass. 1104 (2014), the Massachusetts Appeals Court followed *Culhane* and ruled that a mortgage borrower's standing to challenge the validity of a mortgage assignment was limited to instances where the borrower alleged that the assignment was void, not voidable. *Sullivan* is also significant because it is the first instance of a Massachusetts appellate court interpreting M.G.L. c. 183, Section 54B in a published decision. There, the Appeals Court reversed the dismissal of a complaint on the ground that the assignment at issue did not comply with the requirements of Section 54B because there was no indication in the assignment that the individual who signed it was an officer of the assignor. *Id.* at 212. The ruling in *Sullivan* confirmed that Section 54B only protects mortgagees against allegations of improper assignments where its terms are strictly complied with. If the requirements of Section 54B were not met, then the assignment may be subject to challenge by the borrower. *See id.*

Later in 2014, the Appeals Court confirmed the *Sullivan* holding and ruled that if the requirements of Section 54B are complied with, then a borrower lacks standing to challenge the assignment because it "cannot be shown to void." *Bank of New York Mellon Corp. v. Wain*, 85 Mass. App. Ct. 498, 503 (2014). This ruling significantly limits the range of claims where a borrower will be able to demonstrate standing to challenge an assignment: borrowers only have standing to challenge assignments that are void, but an assignment that complies with Section 54B "cannot be shown to be void." *Id.* Therefore, borrowers will only have standing to challenge assignments in the rare instance the assignment fails to comply with the "relaxed requirements" of Section 54B. *Id.* (quoting *Sullivan*, 85 Mass. App. Ct. at 212).

Notary Attestations

A 2014 decision in a divorce case, *Allen v. Allen*, 86 Mass. App. Ct. 295 (2014), will likely prove significant in litigation over mortgages. In *Allen*, the Supreme Judicial Court ruled that a document that was not notarized was not entitled to be recorded. *Id.* at 299. Even though the Registry of Deeds accepted the document for recording, the Supreme Judicial Court ruled that a defect in the notary acknowledgement made the document insufficient to provide constructive notice of the conveyance. *Id.* at 300.

Allen is especially significant to mortgages in bankruptcy proceedings. The bankruptcy code provides that a bankruptcy trustee has the rights and powers of a bona fide purchaser of real property. 11 U.S.C. § 544(a)(3). As such, the trustee may avoid unrecorded liens on real property owned by the debtor at the commencement of the case. Several bankruptcy courts have ruled that a materially defective acknowledgement of the debtor's signature on a mortgage allows the trustee to avoid the mortgage. *See, e.g.*, *In re Giroux*, No. 08-14708-JNF, 2009 WL 1458173, at *11 (Bankr. D. Mass. May 21, 2009) *aff'd sub nom*. *Mortgage Elec. Registration Sys., Inc. v. Agin*, No. 09-CV-10988-PBS, 2009 WL 3834002 (D. Mass. Nov. 17, 2009); *In re Bower*, No. 10-10993-WCH, 2010 WL 4023396, at *6 (Bankr. D. Mass. Oct. 13, 2010); *In re Nistad*,

No. 10-17453-WCH, 2012 WL 272750, at *5 (Bankr. D. Mass. Jan. 30, 2012). *Allen* appears to confirm the reasoning employed by the Bankruptcy Court: a materially defective acknowledgement in a mortgage should prevent it from being recoded and invalid recording means that the trustee may avoid the mortgage. *See Allen*, 86 Mass. App. Ct. at 300.

Miscellaneous 2014 Mortgage-Servicing Decisions of Note

Two other 2014 decisions will also likely affect mortgage-servicing litigation going forward.

In *Easthampton Savings Bank v. City of Springfield*, No. SJC-11612, Slip op. at 13 (Mass. Dec. 19, 2014), the Supreme Judicial Court ruled that the City of Springfield's attempt to create a default mediation program through a local ordinance is preempted by the Massachusetts nonjudicial foreclosure statute, M.G.L. c. 244. This ruling dealt a blow to local attempts to ease the blight created by foreclosed homes. It leaves open the possibility that not all local ordinances directed at blighted foreclosed properties will be preempted by M.G.L. c. 244 by ruling that a Springfield ordinance targeted at upkeep of foreclosed homes by the purchaser at foreclosure was not preempted by Chapter 244.

The Massachusetts Appeals Court also released its long-awaited decision in *Drummer Boy Homes Assn., Inc. v. Britton*, 86 Mass. App. Ct. 624 (2014). There, the Appeals Court ruled that the Massachusetts Condominium Statute, M.G.L. c. 183A, § 6(c) allows a lien for unpaid common-area fees to take priority over a first mortgage on the condominium only for a six-month period. *Id.* In doing so, the Appeals Court rejected the condominium association's claim that it was permitted to "stack" subsequent six-month priority periods by filing successive lawsuits. *Id.*

For more information, please contact Your Hinshaw Attorney.

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[1] Mortgage servicers are entities that collect payments and provide customer service to mortgage borrowers on behalf of the holder of the mortgage.