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Ferguson v. Avelo Mortgage, LLC

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Mortgage Electronic Registration Systems (MERS), as original lender's nominee and beneficiary under deed of trust, and its later assignee had authority to initiate foreclosure proceedings and invoke the tender rule against tenants seeking quiet title again

In November 2006, Owner bought Home, with New Century Mortgage Company as lender, Mortgage Electronic Registration Systems (MERS) as lender's nominee and beneficiary under the deed of trust, and First American Title as trustee. On August 2, 2007, Avelo Mortgage executed a substitution of trustee, replacing First American with Quality Loan Service Corporation. On August 22, 2007, MERS assigned its interest under the deed of trust to Avelo. After delinquent loan payments, Quality delivered a notice of sale to Owner on November 4, 2007. The substitution of trustee (from First American to Quality) was recorded on November 9, 2007; on that same day, the notice of sale was recorded. Avelo purchased Home in a nonjudicial foreclosure sale in July 2008 for $400,000 (roughly 60 percent of the amount of unpaid debt and costs).

From the time of initial purchase, Tenants had been occupying Home. On June 27, 2009, Owner executed a quitclaim deed to Tenants. On October 8, 2009, Tenants brought a quiet title action against Avelo. Avelo successfully demurred that, as a prerequisite, neither Tenants nor Owner had tendered the full amount due on the loan, and because the sale had terminated Owner's interest, the postsale quitclaim deed transferred nothing to Tenants. Tenants appealed, arguing that Avelo was not the holder of the promissory note and thus could not invoke the tender rule against them. The court of appeal affirmed both the demurrer without leave to amend and the judgment for Avelo.

On an issue of first impression, the court held that MERS and its valid assignee, Avelo, had authority to initiate foreclosure proceedings and invoke the tender rule against Tenants, even when neither held the original promissory note. The deed of trust specifically allowed MERS to initiate foreclosure proceedings. Under persuasive federal case law, it is not necessary that MERS or Avelo, as its assignee, have possession of the original promissory note as a precondition to a nonjudicial foreclosure under the deed of trust. The court characterized the argument that MERS or Avelo must have possession of the promissory note as a "legal loophole," benefiting defaulting borrowers and their successors, that was not supported by any legal authority.

Although Avelo did not have authority to substitute trustees initially, rendering the notice of default defective, Owner had 3 months before the notice of sale to cure his default. Further, when Avelo did become beneficiary under the deed of trust on August 22, 2007, the recordation of the trustee substitution on November 9, 2007, became effective and was valid. Because the foreclosure sale occurred in July 2008, the sale was *completed* with a valid, existing trustee. Tenants were bound by the equitable tender rule, even though they were not the original borrowers, because they stood in the shoes of Owner as owners in possession of the property. (Note: As owners in possession arguing that Avelo had no legal or equitable right to foreclose, Tenants sufficiently pleaded their quiet title action.)

THE EDITOR'S TAKE: If two decisions constitute a trend, then the combination of this case with *Gomes v Countrywide* (reported in the May 2011 Reporter) should tell us that the California state appellate courts are going in the opposite direction of many federal bankruptcy court decisions and are generally upholding secondary market transfers involving the MERS System even when there is something dubiously fishy in the transaction (as when, such as here, the new lender substituted in a different trustee before the deed of trust had been actually assigned to it).

What this decision also adds to the judicial rehabilitation of MERS is that the new lender can demand that the trustor tender the loan funds as a precondition for challenging its foreclosure, notwithstanding the trustor's argument that the assignment from MERS covered only the deed of trust and not the promissory note (which MERS never possessed), putting into doubt the question of whether the foreclosing lender actually does possess the underlying note.

(Use of the tender defense in these circumstances has almost more of a poetic-justice logic than any solid legal justification—it being so often raised in response to the trustor's attempt to stop the foreclosure by the "show me the note" defense. Neither of these challenges—not "show me the note" or "show me you can tender the debt"—has much to do with the real merits of most foreclosure fights; they serve too often as dodges to avert attention from the real substantive issues of whether the trustor actually does owe the money or whether the lender actually is entitled to the money.)

The tender defense has always seemed troublesome to me. In many mortgage challenge cases, a court should not quiet the mortgagor's title without also, at the same time, recognizing the validity of the mortgagee's debt, but when that debt is not yet immediately due, why should the mortgagor be required to tender it *in full* at the outset of the litigation? Too many appellate opinions dogmatically state this as a requirement without adequate explanation (or find some way to avoid applying it when it appears inconvenient). Practitioners deserve more certainty as to why, how, or when a tender requirement applies.

PS: I mentioned earlier in this *Take* that the federal courts appear to be going in a somewhat different direction, which is best illustrated by this excerpt from a recent opinion from the Central District of California (*Cruz v Wachovia Mortgage* (CD Cal, Mar. 8, 2011, No. CV 10–3412 AHM (JEMx)) 2011 US Dist Lexis 24784), following its dismissal of a trustor's challenge to a foreclosure on preemption grounds, but then turning to the question of attorney fees for the lender:

Now Wells Fargo Bank seeks to punish Plaintiffs for daring to sue it. Why does a giant bank like Wells Fargo seek to recover $18,552.50 from struggling plaintiffs who probably never understood, must less commissioned, the ill-advised theories and pleadings their lawyer came up with? Perhaps because it wishes to obtain a precedent that banks could use to deter unsophisticated borrowers like Plaintiffs from suing them. If that was its intention, Wells Fargo picked the wrong case and the wrong court....

These fee-shifting recitals are fine print, boilerplate clauses in complicated legal instruments that, from a practical point of view, are tantamount to contracts of adhesion. How many consumers read such fine print? How many understand it?

Plaintiffs are already facing the loss of their home. To saddle them with nearly $20,000 in attorneys' fees sought by a giant financial institution merely because they had the temerity to file a lawsuit would be worse than inequitable and unreasonable; it would be a travesty.

Attorneys scheduled to appear before Judge Matz in the Central District: Be warned.—*Roger Bernhardt*