Featured Article

Potocki v. Wells Fargo Bank, N.A.: The Need for Clarity When Investors Disallow Loan Modifications

By Matthew B. Learned, Esq., McCarthy Holthus

Since the enactment of the California Homeowners' Bill of Rights (the "HOBR"), and specifically the "dual tracking" prohibitions contained therein, borrowers have had increasing success in surviving the pleadings stage of wrongful foreclosure lawsuits. Simple allegations that a lender failed to review a loan modification application before initiating or completing a nonjudicial foreclosure sale can be enough – whether true or not – for a court to overrule a lender's demurrer.

Even if a lender completes its review and issues a substantive loan modification denial letter, there are still pitfalls lenders should be aware of if the denial is based on investors disallowing modifications as shown in the recent case of *Potocki v. Wells Fargo Bank, N.A.*, decided by the Third Appellate District on July 11, 2019.[1]

> ***"Even if a lender completes its review and issues a substantive loan modification denial letter, there are still pitfalls lenders should be aware of if the denial is based on investors disallowing modifications."***

The borrowers in *Potocki* purchased their home in Sacramento, California in May of 2004. Six months later, Thaddeus J. Potocki and Kelly Davenport refinanced their purchase-money loan with a $500,000 stated-income loan secured by a deed of trust against their Sacramento property. The loan went into default and the borrowers sought loss mitigation assistance from the lender in order to avoid foreclosure. In early 2014, the lender reviewed the borrowers for two separate modifications: a modification under the Home Affordable Modification Program ("HAMP") and a non-HAMP "trial payment plan" modification.

The lender subsequently denied the borrowers for the HAMP modification. The HAMP denial letter expressly stated that the lender could not modify the loan "because '[We] do not have the contractual authority to modify your loan because of limitations in our servicing agreement.'"[2] However, the borrowers were approved for the non-HAMP modification. The borrowers were required to make three trial payments, the first of which was $171,745.78, in order to qualify for the non-HAMP modification.[3] The non-HAMP modification was rejected by the borrowers.

Following multiple bankruptcies, and a prior civil action, the borrowers filed a complaint in March 2014 asserting claims for negligence, statutory violations and sought declaratory relief in regards to the nonjudicial foreclosure. Several rounds of pleadings followed and the lender's demurrer to the borrowers' third amended complaint was eventually sustained without leave to amend.[4]

Thaddeus Potocki and Kelly Davenport appealed the judgment of dismissal. The issue on appeal was whether the lender's loan modification denial letter was sufficiently detailed as to satisfy the requirements of Civil Code section 2923.6.[5]

Civil Code section 2923.6 provides that if a denial was based on investor disallowance, the specific reasons for the investor disallowance must be given.[6] In *Potocki*, the Court found that the language contained in the HAMP denial letter communicated "little more than the modification was denied because the investor did not want to approve it."[7]

The lender argued that the borrowers could only bring a claim for a "material" violation of 2923.6 and there was no material violation in this case because the borrowers failed to show that they would have obtained a more favorable outcome absent the purported violation. The Court was not persuaded finding that "[w]ithout knowing the investor's actual reason for denying the HAMP modification, we cannot say for certain that the failure to provide 'specific reasons for the investor disallowance' was not material."[8] As such, the Court reversed the judgement of dismissal and the trial court's order sustaining the lender's demurrer only as to the 2923.6 cause of action.

It remains to be seen whether language like what was used in the *Potocki* HAMP denial letter will be sufficient, either

on summary judgment or at trial, to defeat dual tracking claims under section 2923.6. Regardless, courts have awarded borrowers attorneys' fees as the prevailing party under section 2924.12(i) – simply by obtaining a temporary restraining order premised on HOBR claims. It is clear from *Potocki* that lenders should mindful of these issues when crafting their loss mitigation correspondence. To avoid similar challenges to their denial letters, lenders should consider referencing specific guidelines in their servicing agreement as the "specific reasons for the investor disallowance."

1 *Potocki v. Wells Fargo Bank*, N.A. (2019) 38 Cal.App.5th 566.

2 *Potocki* at 568.

3 *Potocki* at 569.

4 The Plaintiffs' third amended complaint included a cause of action for violation of Civil Code section 2923.6.

5 *Potocki* at 568.

6 Cal. Civ. Code § 2923.6(f)(2).

7 *Potocki* at 570.

8 *Potocki* at 571.

Matthew B. Learned is a Senior Associate in the Civil Department with McCarthy & Holthus, LLP. He has been with the firm for over 11 years and practices primarily in the areas of foreclosure litigation and title disputes. Mr. Learned can be reached at mlearned@mccarthyholthus.com.