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SUPERIOR COURT OF THE STATE OF CALIFORNIA

FOR THE COUNTY OF SANTA BARBARA

Brian P. Milburn, Plaintiff, vs. Bank of America; BAC Home Loans Servicing, LP; ReconTrust Company, N.A., and Does 1 through 30 inclusive, Defendants.	Case No. 1381087 **PLAINTIFF'S OPPOSITION TO DEMURRER** Assigned to: Hon. Donna Geck Date: November 2, 2011 Time: 9:30 a.m. Department: Four

I. THE FORECLOSURE IS WRONGFUL BECAUSE PLAINTIFF IS NOT IN DEFAULT.

Plaintiff has alleged that he is not in default. Plaintiff's allegation is that between the time of the Tea Fire and the Bank's initiating the nonjudicial foreclosure process, he has actually paid to the Bank more interest than he rightfully owed. Plaintiff alleges that the Bank should have reduced the principal amount of his loan by the amount of the insurance proceeds he forwarded to the Bank. The Bank should have done so as soon as plaintiff notified the it that it would not be economically feasible to rebuild a house on the property for the amount of money available from the insurance policy.

If the Bank had applied the insurance proceeds to the balance of the loan, plaintiff's monthly interest charges would have been significantly less. The complaint includes allegations with respect to the amounts of money involved to support this allegation. It alleges that the excess interest which was charged by the bank, which he paid, during this period of time exceeds the amount which the Bank states is in arrears.

If a borrower is not in default, the lender has no right to foreclose. (See, *Bisno v. Sax*, 175 Cal.App.2d 714, 346 P.2d 814 (1960) [acceptance of payment curing default precludes foreclosure sale]; *Baypoint Mortgage v. Crest Premium Real Estate Investments Retirement Trust*, 168 Cal.App.3d 818, 214 Cal.Rptr. 531 (1985) [payment made during period before incurring late payment charges insufficient to justify foreclosure]; *Bank of America v. La Jolla Group II*, 129 Cal.App.4th 706, 28 Cal.Rptr.3d 825 (2005) [pre-sale agreement with respect to curing of default extinguishes right to foreclose].

The Bank asserts that plaintiff's allegations are insufficient to make out a wrongful foreclosure claim, because, it says, it was under no obligation to apply the insurance proceeds to the principal balance of the loan. The trust deed provides that if it is not economically feasible to rebuild, the bank "shall" apply the insurance proceeds to the loan. The Bank argues that it has the right to unilaterally decide whether rebuilding is economically feasible. However, there is no language in the trust deed which gives the Bank such right.

On page 6 of its demurrer, the bank argues that the deed of trust does not give the borrower the right to unilaterally determine whether rebuilding is economically feasible. It then states that the economic-feasibility provision of the trust deed is intended to protect its security interest. It then engages in a leap of logic by stating that the Bank has "thus retained the discretion to allocate the insurance proceeds towards restoration and repair[.]" (Demurrer, at 6:5-6.) The Bank refrains from claiming that it has the right to unilaterally determine the feasibility of rebuilding. Nor does it say that it ever has made such a determination. Nor does it state that it at any time gave the borrower notice of any such determination. It never has. To the contrary, the first time the Bank has ever mentioned anything about this issue to plaintiff was in the Bank's demurrer. The Bank simply makes the unsupported statement that it can allocate the insurance proceeds however it wants.

The language in the trust deed pertaining to insurance proceeds and rebuilding clearly is written to protect the lender from a borrower's unreasonably asserting that it is economically feasible to rebuild with insurance proceeds. It is not intended to provide a source of gamesmanship by the lender, in which the lender continues to maintain control of the insurance proceeds, while foreclosing on the property without applying the proceeds to the debt. One commentator viewed the rationale for the mortgage provision as follows:

> "For the bank, the initial collateral has disappeared. The primary concern is that the homeowner, given the chance, might take new primary collateral - the money - and run. Of secondary concern is that the homeowner will spend all the money, but will rebuild a home of insufficient value to adequately collateralize the loan."

Kenneth S. Klein, Following the Money - The Chaotic Kerfuffle When Insurance Proceeds Simultaneously Are the Only Rebuild Funds and the Only Mortgage Collateral, 46 Cal. W. L. Rev. 305, 325 (2010).

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II. PLAINTIFF HAS PROPERLY ALLEGED CAUSES OF ACTION FOR BREACH OF CONTRACT, WRONGFUL FORECLOSURE, AND DECLARATORY RELIEF.

A complaint for breach of contract must include the following: (1) the existence of a contract, (2) plaintiff's performance or excuse for non-performance, (3) defendant's breach, and (4) damages to plaintiff therefrom. (*Acoustics, Inc. v. Trepte Construction Co.* (1971) 14 Cal.App.3d 887, 913 (1971).) Actions for breach of the terms of a mortgage, for declaratory relief with respect to the mortgage, and for injunctive relief with respect to a mortgage all are actions on a contract. (See, *Kachlon v. Markowitz*, 168 Cal.App.4th 316, 348 (2008).)

Here, plaintiff alleges that the Bank has breached its duty under the terms of the mortgage contract by foreclosing on the mortgage without plaintiff's being in default. Thus, breach of contract and wrongful foreclosure are clearly properly alleged in the complaint. See, *Kachlon v. Markowitz*, supra.)

As a result of the Bank's improper actions, plaintiff is rightly seeking declaratory relief because there is "an actual controversy relating to the legal rights and duties of the parties." (C.C.P. § 1060.) An action for declaratory relief is proper when plaintiff seeks injunctive relief with respect to a pending foreclosure. (*Lomanto v. Bank of America*, 22 Cal.App.3d 663 (1972).) The cause of action for declaratory relief is therefore legitimate in this case.

III. PLAINTIFF PROPERLY SEEKS AN AWARD OF PUNITIVE DAMAGES.

A foreclosure trustee or foreclosing lender may be liable to the borrower for damages sustained where there has been an illegal, fraudulent or wilfully oppressive sale of property under a power of sale contained in a mortgage or deed of trust. (*Munger v. Moore*, 11 Cal.App.3d 1 (1970).) Punitive damages may be awarded in a wrongful foreclosure case if the defendant's acts were malicious. (*Kachlon v. Markowitz*, 168 Cal.App.4th 316, 336 (2008).)

For purposes of liability and punitive damages in such situations, the lender's recording a notice of default and a notice of trustee's sale are treated as publications. (*Kachlon,* supra.) There is a qualified privilege to record these documents under Civil Code § 47. (*Id.*) However, there is no privilege, and punitive damages may be awarded, if the lender acted with malice. (Id.)

Malice is shown in a wrongful foreclosure case if can be shown that "the publication was motivated by ill will towards the plaintiff or by a showing that the defendant lacked reasonable grounds for belief in the truth of the publication and therefore acted in reckless disregard of the plaintiff's rights." (*Id.*) Malice may be inferred, and therefore punitive damages are appropriate, if it is shown that the lender was motivated by ill will toward the borrower, or by a showing that the defendant lacked reasonable grounds for belief in the truth of the publication, meaning here the legitimacy of the foreclosure. (Id.)

Here, plaintiff has made allegations which would support an inference that the bank

lacked reasonable grounds for belief that plaintiff is in default. Under such circumstances, it would be appropriate for the court to award punitive damages. Therefore, the demurrer should be overruled with respect to plaintiff's seeking punitive damages in this case.

IV. PLAINTIFF'S ALLEGATIONS ARE SUFFICIENT TO REQUIRE AN ACCOUNTING BY THE BANK.

The allegations in this suit are that the Bank wrongly refuses to apply the insurance proceeds to the debt, and that it is moving forward with a foreclosure notwithstanding plaintiff's protests that the loan is current because of the excess interest he has paid. It is far from clear how much plaintiff owes the Bank. Most importantly, the parties disagree as to whether the amount of the insurance proceeds should be factored into in computing the amount of the debt.

When the beneficiary of a deed of trust commences a nonjudicial foreclosure, it is obligated to provide the trustor with an accurate accounting of the amount owed. (Civil Code § 2924c(b)(1).) If the amount is in question, the court may order the beneficiary to provide an accounting. (See, e.g., *Anderson v. Heart Federal Sav. & Loan Assn.*, 208 Cal.App.3d 202 (1989). The court may, and should, order an accounting in this case given these major disputes about the amount owed. Plaintiff's including a cause of action for an accounting is therefore appropriate under the circumstances of this case.

V. BECAUSE THE AMOUNT WHICH IS OWED IS UNCERTAIN, A PRE-SALE INJUNCTION IS APPROPRIATE.

Where the amount due on a mortgage is uncertain, a nonjudicial foreclosure will be enjoined until the equities between the parties can be settled, and the balance due is ascertained. *(More v. Calkins*, 85 Cal. 177 (1890).) In like manner, if a lender initiates a nonjudicial foreclosure based on a debt on which the statute of limitations has run, the court will enjoin the foreclosure. (*Goldwater v. Hibernia Savings & Loan Society*, 19 Cal.App. 511 (1912).)

In *Baypoint Mortgage v. Crest Premium Real Estate etc. Trust*, 168 Cal.App.3d 818, the borrower failed to timely make certain payments. However, the untimeliness was insubstantial. Nonetheless, relying on the untimely payments as events of default, the lender initiated a nonjudicial foreclosure. The borrower sought an injunction stopping the foreclosure. The trial court enjoined the foreclosure, and the Court of Appeal affirmed. The rationale of the court was that the borrower would face greater harm from denial of an injunction than the lender would from issuance of an injunction. (Accord: *Bisno v. Sax*, 175 Cal.App.2d 714 (1959) pre-sale injunction against foreclosing lender proper where lender had unjustifiably rejected the borrower's tender of payments].)

Another factor which supports the award of injunctive relief in this case is that the amount of the insurance proceeds held by the bank (approximately $600,000) added to the value of the property (approximately $350,000) exceed the amount owed on the debt (approximately $900,000). The bank therefore is fully secured, and any harm to it caused by enjoining the

foreclosure would be diminished accordingly.

VI. WHERE A TRUSTOR SEEKS TO ENJOIN A PENDING FORECLOSURE BASED ON NON-PROCEDURAL REASONS, TENDER IS NOT REQUIRED.

The Bank argues that plaintiff must allege "that he tenders the amount due under the loan." (Demurrer, at 5:15.) That argument lacks support. Whether a plaintiff is required to make such tender appears in the reported cases largely in post-foreclosure suits brought to set aside an already-completed sale on procedural grounds. All of the cases cited by the Bank in support of its "tender" argument are indeed post-foreclosure cases in which the plaintiff seeks to set aside a pending sale on procedural grounds. As a result, they are readily distinguishable to the instant case. The cases cited by the Bank are:

Karlsen v. American Savings & Loan Assn., 15 Cal.App.3d 112 (1971). *Karlsen* was a post-foreclosure case brought by a second lienor, complaining of irregularities in certain requisite notices. The lender had bid in at the foreclosure sale, and then sold the property to a related entity. The court observed that the defendant admitted that the foreclosure sale was voidable because of the sale. The court also concluded that the plaintiff was required to allege unconditional tender in her complaint in order to proceed. The court found that the language in the complaint did not constitute adequate tender. Therefore, the foreclosure sale was not set aside.

Arnolds Mgmt. Corp. v. Eischen, 158 Cal.App.3d 575 (1984). *Arnolds* was a post-foreclosure case in which the plaintiffs were lienors junior to the foreclosed lien. They alleged that the sale should be set aside for procedural irregularities related to notice. The *Arnolds* court extended the principle of *Karlsen*, supra, requiring an allegation of tender, to apply not only to the borrower, but also to a beneficiary of a junior deed of trust. The junior lender in *Arnolds* did not make such tender, so the sale was not set aside.

United States Cold Storage v. Great W. Sav. & Loan Ass'n., 165 Cal.App.3d 575 (1985). *U.S. Cold Storage* was another post-foreclosure challenge to a foreclosure on procedural grounds. As in *Arnolds*, supra, an issue in *U.S. Cold Storage* was whether a junior lienor must tender full payment of the senior lien in order to maintain a suit to set aside a foreclosure sale on the basis of improper notice. The court took note of *Arnolds*, which was decided while the case before it was pending. It decided that it would not be appropriate to apply *Arnolds* retroactively to the case before it, so as to prevent the junior lienor from proceeding on the merits. However, the court ultimately found against the junior lienor on other grounds.

Abdallah v. United Sav. Bank, 43 Cal.App.4th 1101 (1996). Abdallah

also was a post-foreclosure case. In *Abdallah*, the court considered an attempt by a junior lienholder to avoid a foreclosure sale which sale was based on a senior all-inclusive trust deed, based on defects in notice. The *Abdallah* court followed the rule of *Arnolds*, supra, and held that the a lienholder in a position junior to an all inclusive trust deed was obligated to tender the entire amount of the senior lien as a condition to its maintaining an action to set aside the foreclosure sale for irregularity in its procedure. It therefore affirmed the lower court's refusal to issue an order voiding the sale.

Alicea v. GE Money Bank, No. 09-00091, 2009 WL 2136969 (N.D. Cal. 2009). Alicea was another post-foreclosure attempt to avoid a foreclosure sale for procedural reasons (defective notice). The borrower alleged that the sale should be set aside because the notice of sale did not sufficiently inform her as to whom she should tender payment. The court in *Alicea* concluded that tender was required under such circumstances. The court than concluded that that "[t]he Complaint does not allege any tender of payment, rendering the claim deficient on its face." (*Id.*, at *3.) The court therefore dismissed the complaint in its entirety.

In its demurrer, the Bank quotes a comment by the court in *Alicea*, that the requirement of tender applies "[w]hen a debtor is in default of a home mortgage loan, and a foreclosure is either pending or has taken place[.]" (Demurrer, at 4:27-5:1, quoting from *Alicea*.) That comment is dicta. The *Alicea* court did not have before it the question whether the tender rule applied to both pre-sale cases and post-sale cases. Rather, it had before it a post-sale situation with allegations of irregularities in the foreclosure procedure. It rightly applied the tender rule. But its stated rationale went beyond the scope of the facts before it. *Alicea* was not an appellate case.

The present case is not a post-foreclosure case. Nor is it a case in which the borrower is challenging the procedure used in the foreclosure. Rather, this is a pre-sale case in which plaintiff seeks an injunction against a pending nonjudicial foreclosure on the basis that the loan is not in default. Where the amount due under a mortgage is uncertain, a foreclosure will be enjoined until the balance due can be ascertained. (*More v. Calkins*, 85 Cal. 177 (1890).) There is no mention of any tender issue in *More*. Similarly, a foreclosure initiated on insubstantial late-payment issues was enjoined, with no mention of tender, in *Baypoint Mortgage v. Crest Premium, etc.* 168 Cal.App.3d 818 (1985).

There is no bright-line test with respect to when tender should be required in cases brought to enjoin or void a foreclosure. (See, e.g., *Humboldt Sav. Bank v. McCleverty*, 161 Cal. 285 (1911) [tender not required in post-sale petition to avoid sale and to marshal the sequence of liens to be foreclosed so as to protect widow's homestead].) The issue of tender in general, the *Humboldt* decision in particular, and the absence of any bright-line test as to when tender is or is not required, are all fully discussed in *Storm v. America's Servicing Co.*, fn. 9, at *6, 2009 WL

3756629 (S.D. Cal. 2009). The court in *Storm* concluded after reviewing these cases and more, was that there is no clear test as to whether tender is or is not required, and that it was a matter left to the discretion of the court.

VII. THE BANK MAY NOT UNILATERALLY EITHER TO DECIDE WHETHER REBUILDING ON THE PROPERTY IS ECONOMICALLY FEASIBLE OR TO WHERE THE INSURANCE PROCEEDS SHOULD BE DIRECTED.

This issue is discussed somewhat in Section I of this brief. The Bank asserts that the trust deed does not give the borrower authority to unilaterally decide whether rebuilding is economically feasible. It then jumps to the conclusion that it may therefore direct the insurance proceeds to be applied or used as it sees fit.

That position is nothing less than bizarre. The Bank has never informed plaintiff that it had concluded that rebuilding is economically feasible. Has it done so? Who within the bank has made that conclusion? Does the borrower have a role in the determination of economic feasibility? Has the Bank conducted a market study? Does it have an estimate from a contractor? Is it the Bank's position that the plaintiff, should be required to borrow further against the property to rebuild it? If so, whom does he borrow the money from? Is the Bank suggesting that it would lend him such funds? Most importantly, does the language in the trust deed compel plaintiff to rebuild? It certainly does not.

The present case is on all fours with *West v. Nationwide Trustee Services, Inc.*, No. 1:09cv295-LG-RHW, 2009WL 4738171 (S.D. Miss. 2009). *West* is not an appellate case. Nor is it a California case. However, it is a case very similar to the one at bar. California state courts may consider unpublished federal district court opinions as persuasive, even though they are not binding. (*Futrell v. Payday California, Inc.*, 190 Cal.App.4th 1419, 119 Cal.Rptr.3d 513 (2010).)

West involved a form mortgage with language identical to the language in the one at bar. There, defendant Chase Bank held two mortgage loans with respect to plaintiff's property, totaling $328,000. Plaintiff's house burned to the ground. She received an insurance settlement of only $47,000. She remitted the check to Chase, and tendered the amount to Chase to be applied against her balance. Chase refused to accept the tender.

For the next two years, the plaintiff continued to make monthly payments on the full amount of the loans, while repeatedly telling Chase that repairs were not economically feasible and requesting that it apply the insurance proceeds to reduce the principal. Chase continued to refuse. Plaintiff fell behind in her payments, and Chase then initiated a nonjudicial foreclosure.

Plaintiff sued for a declaratory judgment, negligence, breach of good faith and fair dealing, wrongful foreclosure, and for an accounting. She requested that the court issue an injunction against Chase's conducting a foreclosure sale. The matter was before the court on a motion to dismiss the complaint, filed by Chase and Nationwide, which was the trustee.

The District Court rejected the motion to dismiss with respect to all of the causes of action in the complaint. It viewed the allegations as essentially stating that Chase caused the default. It found that plaintiff had sufficiently alleged claims for declaratory relief and wrongful foreclosure. The court noted that Mississippi law allows the award of punitive damages if a lender is found to have pursued a foreclosure with malice. The court therefore did not strike the demand for punitive damages.

West is virtually indistinguishable from the present case. The language being construed by the court was the exact same form language as the language in the present case. The case was before the court on essentially the same type of motion as the present demurrer. Plaintiff respectfully submits that it is appropriate for this court to look to *West* for some guidance with respect to the demurrer before it.

VIII. THE COMPLAINT STATES A CLAIM FOR BREACH OF THE COVENANT OF GOOD FAITH AND FAIR DEALING.

"Every contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." (*Foley v. Interactive Data Corp.* 47 Cal.3d 654, 683–684 (1988).) "The covenant of good faith finds particular application in situations where one party is invested with a discretionary power affecting the rights of another. Such power must be exercised in good faith." (*Carma Developers (Cal.), Inc. v. Marathon Development California, Inc.*, 2 Cal.4th 342, 371-372 (1992).) 371–372, 6 Cal.Rptr.2d 467, 826 P.2d 710.) This principle applies in nonjudicial foreclosure cases. (See, *Hicks v. E.T. Legg & Associates*, 89 Cal.App.4th 496 (2001).)

Here, the Bank's discretionary power to commence a nonjudicial foreclosure with respect to plaintiff's property requires the Bank to exercise its discretion in good faith. (See, Hicks, supra.) The Bank has not done so. It has done the opposite. It has refused to accept, or even discuss, plaintiff's position that reconstructing a house on the property is not economically feasible. It has also refused to apply the insurance proceeds which it holds to the balance of the loan. As a result, it has charged plaintiff much more interest than is appropriate.

The Bank's requiring plaintiff to pay interest on the entire amount of the loan, while holding the insurance money hostage (and presumably putting it to its own use), has led directly to plaintiff's finally having to stop making payments on the note. That, in turn, precipitated the Bank's initiating the nonjudicial foreclosure process. Plaintiff submits that those allegations are more than sufficient to make out a claim for breach of the covenant of good faith and fair dealing.

IX. THE BANK IS REQUIRED TO PAY INTEREST ON THE INSURANCE PROCEEDS IT HOLDS.

Plaintiff's has alleged in the alternative that the Bank is obligated to pay interest of 2% per annum on the insurance proceeds it holds, as is required by Civil Code § 2954.8(a). The

Bank asserts that the statute doesn't apply because, it says, the statute only applies to impound accounts. Not so. Section 2954.8(a) provides:

> "Every financial institution that makes loans upon the security of real property containing only a one- to four-family residence and located in this state or purchases obligations secured by such property and that receives money in advance for payment of taxes and assessments on the property, for insurance, or for other purposes relating to the property, shall pay interest on the amount so held to the borrower. The interest on such amounts shall be at the rate of at least 2 percent simple interest per annum. Such interest shall be credited to the borrower's account annually or upon termination of such account, whichever is earlier." [Emphasis added to show portion quoted by Bank in its demurrer at 7:31-23.]

Impound accounts are not mentioned at all in subdivision (a) of section 2954.8. Nor are they mentioned in any other of the remaining three subdivision, (b), (c), or (d) of the statute. The Bank glosses over part of the language of the statute which it quotes in its demurrer, ". . . or for other purposes relating to the property . . ." The Bank has not pointed to any law supporting its position that that phrase doesn't encompass the insurance proceeds it holds. At least one commentator sees the issue differently than the Bank does:

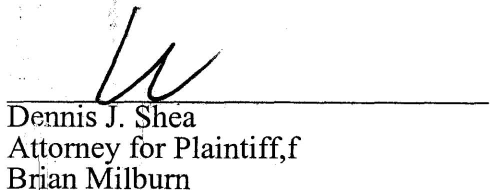
> "A handful of states have statutes requiring the payment of interest on escrow and/or similar accounts. California's law requires payment of interest on any funds held by the bank for 'purposes relating to the property,' and so would include insurance proceeds held by the bank[.]"

Kenneth S. Klein, Following the Money - The Chaotic Kerfuffle When Insurance Proceeds Simultaneously Are the Only Rebuild Funds and the Only Mortgage Collateral, 46 Cal. W. L. Rev. 305, 325 (2010). The demurrer should therefore be overruled with respect to plaintiff's alternative claim for 2% statutory interest on the insurance proceeds.

X. CONCLUSION.

For the reasons stated above, the court should overrule the demurrer of the Bank with respect to all of plaintiff's causes of action.

Dated: October 20, 2011



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Brian Milburn

PROOF OF SERVICE

DECLARATION OF SERVICE BY MAIL AND BY E-MAIL

STATE OF CALIFORNIA

COUNTY OF SANTA BARBARA

I, Dennis J. Shea, am over the age of eighteen years and not a party to the within entitled action. My business address is 903 State Street, Suite 208, Santa Barbara, California.

On October 20, 2011 I served a copy of the within **PLAINTIFF'S OPPOSITION TO DEMURRER** on the interested parties by certified mail with the United States Postal Service at Santa Barbara, California a true copy of the above-referenced document(s), enclosed in a sealed envelope, postage prepaid, addressed as follows:

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And by e-mail to: bspohn@reedsmith.com

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct.

Dated: October 20, 2011

Dennis J. Shea