Gonzalez Provides Lessons for Borrowers, Lenders

By Michael R. O'Donnell, Ronald Z. Ahrens and Anthony Valenziano

In *Gonzalez v. Wilshire Credit Corporation*, 207 N.J. 557 (2011), the New Jersey Supreme Court extended the reach of the New Jersey Consumer Fraud Act, N.J.S.A. 56:8-2 (CFA) to cover deceptive practices in connection with a post-foreclosure settlement agreement.

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In *Gonzalez*, the plaintiff, a non-English speaker with an elementary school education, brought suit against Wilshire Credit Corporation as loan servicer and U.S. Bank as lender under the CFA, alleging that Wilshire, in recasting her loan as part of a settlement agreement on two separate occasions, violated the CFA when it included additional hidden charges and miscalculated the amounts due on her loan in the settlement agreement. Beginning with the proposition that the CFA was intended to be interpreted broadly, the court stated that the CFA covers deceptive practices in connection with the "subsequent performance of the extension of credit." (Id. at 577.) Thus, "collecting or enforcing a loan, whether by the lender or its assignee, constitutes the 'subsequent performance' of a loan, an activity falling within the coverage of the CFA." (Id. at 577-78.)

The court characterized the first and second agreements between the plaintiff and Wilshire as "nothing more than a recasting of the original loan." (Id. at 580.) In analyzing the nature of the subsequent post-foreclosure agreement, the court rejected the defendant's argument that the loan merged into the final foreclosure judgment, stating that the "presumption of merger" yields to equitable considerations and the conduct alleged precluded the defendant from arguing that the post-judgment agreements were not attempts to recast the loan. (Id. at 580-81.) The court held that regardless of whether the loan "merged" upon foreclosure, "the post judgment agreements, standing alone, constitute the extension of credit, or a new loan." (Id. at 581.) Integral to the court's finding was that the lender treated the agreement as an extension of the loan versus a pay-off of the foreclosure judgment. For example, the lender sought the note's rate of interest (11.25 percent) rather than the judgment rate. (See Id.)

The court also noted that the defendant's practices should not be immune to the protections of the CFA in light of the "unprecedented foreclosure crisis" and the fact that it is often the poor and uneducated who are the victims of predatory lending schemes. (Id. at 582.) As such, the CFA provides attorneys incentive to take on these cases where the client may not be able to afford an attorney. (Id. at 584-85.) The court also rejected the argument that permitting a party to pursue a CFA claim in connection with a post-foreclosure settlement would curtail commerce as other business activities subject to the CFA have not suffered due to its protections. (Id. at 586.)

When considering the plaintiff's allegations, the court seemed particularly troubled by the fact that the plaintiff was unable to speak English and possessed only an elementary school education, something that Wilshire was aware of when it entered into the settlement agreement with the plaintiff. (Id. at 583.) "The victims of these unsavory practices are most often the poor and uneducated, in many circumstances those with little understanding of English, and therefore the 'need' for the protections of the CFA is 'most acute' in such cases," according to the court. Also troublesome to the court was Wilshire's decision to directly contact the plaintiff when it had been aware for over a year that the plaintiff was represented by a legal services attorney in connection with the foreclosure proceedings. (See Id.)

Based on these facts, the court held that the "post-foreclosure judgment agreements in this case were both in form and substance an extension of credit to plaintiff originating from the initial loan" and subject to the protections of the Consumer Fraud Act. (Id. at 563.) The court was careful to limit its holding to "post-foreclosure-judgment agreements involving a stand-alone extension of credit," i.e., a forbearance agreement. It expressly stated that the CFA does not apply to all settlement agreements in general. (Id. at 586.) Further, the decision in *Gonzalez* appears limited to the situation where a settlement agreement in a foreclosure proceeding results in a forbearance or loan modification agreement.

When rendering its opinion, the court also completely side-stepped the New Jersey Bankers Association's argument that expanding the CFA to include post-foreclosure judgment settlement agreements would cause confusion in the New Jersey judicial system because foreclosure actions are required to be filed before the Chancery Division, while CFA actions would be able to be brought in the Law Division. As a result, absent contractual provisions to the contrary, lenders and servicers will now be subject to Law Division jury trials regarding CFA claims related to foreclosure modifications and settlements.

Given the holding in *Gonzalez*, lenders should, nonetheless, be particularly

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concerned about potential exposure to consumer fraud claims in connection with loan work-outs and post-foreclosure settlements, which carry significant statutory damages (i.e., treble damages and attorneys' fees). *Gonzalez* makes clear that the New Jersey judiciary will view any inequitable or deceptive behavior with great skepticism. In order to avoid the taint of a CFA violation, lenders would be well-advised to review their foreclosure settlement practices.

Among other things, lenders should consider the following:

Have a clear, explainable rationale for the terms of the pre- and post-settlement or loan modification. The court in *Gonzalez* was disturbed by the fact that Wilshire was unable to explain to the plaintiff how it arrived at the amounts owed in the settlement agreement. Indeed, the court expressly noted the fact that Wilshire was unable to explain how it had arrived at the arrearages figures in the agreement, and could not explain how the plaintiff's loan was not current given the excess payments the plaintiff had made. Thus, a lender should take care to ensure that the terms (including the payment amounts) of a settlement are understandable.

Do not charge fees that cannot be justified: The court described the plaintiff's experience with Wilshire as a "credit merry-go-round, a never-ending ride driven by hidden and unnecessary fees that would keep her in a constant state of arrearages." (Id. at 583.) There, the court also highlighted payments for homeowners' insurance that the plaintiff was required to make even though the plaintiff carried proper insurance, and the fact that the arrearages previously due in the foreclosure action, were nearly 40 percent less than what Wilshire calculated was due under the settlement agreement. (Id. at 581.) Thus, a lender must avoid charging unnecessary and/or duplicative additional fees that substantially increase the amount previously due on the loan prior to the foreclosure proceedings or risk a similar CFA claim against it.

Highlight any new or additional charges for the borrower in the settlement agreement from his or her original loan: Again, the court in *Gonzalez* was greatly concerned with hidden or unnecessary fees. (Id. at 583.) A lender should make sure the borrower is aware of how the settlement agreement may change the way his or her loan is calculated, including any new additional fees to which the borrower was previously not subject.

Work through borrower's counsel whenever possible. Given the plaintiff's lack of education and inability to read or speak English, the court highlighted the fact that Wilshire did not work through her counsel, who represented the plaintiff in the foreclosure action, to discuss the purported arrearages. When a lender is aware that the borrower has counsel, especially in a post-foreclosure settlement situation, it should take pains to speak with the borrower's counsel first regarding arrearages or other issues that arise in connection with the settlement agreement.

Carefully consider whether a settlement is the best solution. While the preferred course is to settle foreclosure matters rather than enforce a foreclosure judgment, carefully consider whether a settlement with a particular borrower makes sense or leaves open the possibility of legal claims later. With the court's recent decision in *Gonzalez*, borrowers or certain counsel may automatically resort to filing claims under the CFA after settling a foreclosure action as a way to avoid further foreclosure due to their failure to adhere to the terms of the settlement.

Know your servicer. Lenders will likely be held liable for the violations of the CFA by their loan servicers. Thus, lenders should be aware of – and be comfortable with – their servicer's practices. ■

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concern). Although these ratings are not determinative of any voting recommendation, they are taken into account on a case by case basis and can be influential if there are other indicators of problems as to any proposal. There are numerous policies that a board should consider for adoption that reflect common sense good governance, and that can also positively affect the governance ratings. Among these are the following: clawback policy (requiring repayment of incentive compensation if based on incorrect and restated financial results); anti-hedging policy (prohibiting a director or executive officer from effecting any transaction designed to hedge or offset the economic risk of owning the company's common stock); adopting board governance principles (its governance framework); and a stock ownership guideline for directors.

Sometimes the ISS has their facts wrong, or have selected an inappropriate peer group, and sometimes companies have effectively rebutted the conclusions of the ISS as to SOP, pay for performance and/or other proposals presented. Whether the proxy advisory firms should have the influence that they do, whether they abide by the standards of accountability and transparency that they preach, and whether their influence is for the better in the long run, are legitimate topics for debate. But their influence is a fact, and as with other issues, the well-advised board can and should be prepared and pro-active rather than defensive and reactive. ■

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