

Residential Mortgage Lending: Loan Servicing Developments

A number of reported cases, together with a comprehensive new mortgage loan servicing act, mean that residential mortgage loan servicing in North Carolina will be a more difficult and risky undertaking in the future. Unfortunately, these cases and the new legislation add to an already complicated set of laws and rulings in North Carolina that cover residential mortgage servicing.

I. Fiduciary Duty on Mortgage Servicers

In Smith v. GMAC Mortgage Corp., 2007 WL 2593148 (W.D.N.C. September 5, 2007), the Federal District Court here considered a class plaintiff's contentions that the mortgage holder obligated itself to duties of care and fiduciary duties in holding and administering escrow accounts. The court denied the defendant mortgage holder's Motion to Dismiss and in so doing established troubling precedent for mortgage lenders and mortgage loan servicers. The court considered existing precedent on fiduciary duty under North Carolina law and noted that the whether a mortgagee has a fiduciary duty to a mortgagor under North Carolina law is an issue of first impression. The court stated that earlier decisions had alluded to a fiduciary duty in the mortgagee/mortgagor relationship only in dicta. Nonetheless, using a "significant imbalance in bargaining power" rationale, the court held that a fiduciary relationship existed, binding on the mortgage loan holder in favor of the borrower. It is not clear from the decision whether the mortgagee/mortgagor relationship creates a fiduciary duty on the mortgagee with respect to all aspects of the mortgage transaction. The better reading of the case probably is that the mortgagee or loan holder has such a duty with respect to the collection and handling of escrow accounts and the consequences following from that activity. The case is yet another illustration of bad facts making bad law, because alleged missteps by the loan holder with respect to escrow payments and accounting led to default of the borrower's loan and evidently foreclosure.

II. Standards of Care in Foreclosures

Two recent North Carolina Court of Appeals decisions serve as reminders that mistakes in servicing and in disposition of collateral may be costly. In the case of *In Re Bigelow*, No. COA06-1372 (August 7, 2007), the North Carolina Court of Appeals reviewed evidence of a mortgage holder's refusal to honor a check from the borrower that may have brought the mortgage loan current. The court upheld the trial court's finding that the borrower was not in default and accordingly could not be subjected to foreclosure. The legal basis for the court's decision was rooted in contract law, that a party to a contract (the mortgage holder) could not take advantage of nonperformance of its own obligations to prevent performance by the other party (the borrower). There was no discussion of whether the borrower's tender was proper or legally sufficient. Instead, the court recited testimony from the trial that reflected poorly on the lender's internal servicing actions in the case, referring to them as "bureaucratic tangles" and "apparent lack of communication between different departments of the bank." The remedy against the loan holder was limited to the court's ruling that it could not proceed to foreclosure, but the court left open the possibility for the parties to litigate other claims in any subsequent proceedings. The lesson from this case is that under North Carolina's non-judicial foreclosure law, the courts will find ways to stop residential foreclosures from occurring in the event the loan servicer makes mistakes, even in the absence of bad faith or unfair dealings.

In another very recent case, the North Carolina Court of Appeals reminded lenders who foreclose on real property following default of a mortgage to exercise caution in bidding strategies at the foreclosure sale. It does not appear that the court in this case, *Carolina Bank v. Chatham Station, Inc.*, NO. COA06-1226 (October 16, 2007), broke new legal ground. Rather, the court confirmed that the bid price offered by the holder of the loan at foreclosure

October 2007

establishes the amount of the deficiency that the holder may claim against the borrower. Under the facts of the case, the bank bid the property in at foreclosure and subsequently sold it for significantly less than the bid amount. The court refused to establish the deficiency based on the ultimate sale amount.

III. Comprehensive New Legislation in North Carolina

The North Carolina General Assembly enacted several significant new mortgage lending laws in this past session. *See* McKee & Lampe, "North Carolina Leads Again: General Assembly Expands Mortgage Lending Laws," *Notes Bearing Interest*, October 2007 (published by the Business Law Section of the North Carolina Bar Association). For mortgage loan servicing, all eyes are on HB 1374 (S.L. 2007-352), which represents the first time the North Carolina General Assembly enacted a comprehensive law addressed specifically at residential mortgage loan servicing. The new law, entitled the Mortgage Debt Collection and Servicing Act, becomes effective April 1, 2008. However, the process changes that mortgage servicers will encounter under the Act point to more or less immediate attention to this new law.

To begin with, the new Act covers "home loans," broadly defined as loans secured by real property in North Carolina used or intended to be used as a dwelling. There is not requirement that the loan be consumer purpose or the dwelling be a primary residence. The Act applies to "servicers," as defined in RESPA (excluding attorneys).

Significant new provisions in the Mortgage Debt Collection and Servicing Act include:

- Any fee incurred by a servicer must be assessed within 45 days (or in the case of foreclosure attorney or trustee fees, 45 days from when actually charged) and explained "clearly and conspicuously" in a statement that the servicer must mail to the borrower at least 30 days after assessing the fee. If these procedures are not followed, the servicer is not entitled to the fee.
- All payments to the servicer must be credited within 1 business day, provided that the borrower has made full contractual payment and provided sufficient information regarding the account.
- All fees charged by a servicer must be permitted by law or set forth in the loan documents. As a practical matter this clarifies that most unilateral servicing related fees will no longer be lawful in North Carolina.
- New obligations on the servicer's handling of escrow funds.
- Borrower rights to submit a "request for information" and also dispute his or her account, requiring the servicer to respond within 10 business days.
- An additional qualified written request procedure, enabling the borrower to allege error in his or her account and obtain an explanation from the servicer, which must include a copy of the underlying promissory note. The servicer must provide the information to the borrower in 25 business days.

The Act contains a unique and unprecedented remedies provision, permitting limited cure in the event the borrower desires to bring a civil action against the servicer. HB 1374 contains a number of amendments to existing law, including new, detailed requirements for foreclosure notices and changes in jurisdictional rules related to out-of-state securitization trusts.

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