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August 2009

California Foreclosure Defense Strategies: An Immediate Look at the Best Practices for Assisting Distressed Homeowners in California

Minimize Exposure: Identifying the Ultimate Goal for Your Client -- Dan Goodkin, *Founding Member*, Goodkin & Lynch LLP

By Dan Goodkin

The Current Climate for Lawyers

Foreclosure activity has been fairly localized to certain areas; some areas are worse than others are. For instance, the outlying areas of Los Angeles County (where there was **a** lot of speculative development) are where more of the foreclosures are happening. Areas hit hardest are Riverside, San Bernardino, and other similar types of communities. In fact, California has such **a** large amount of space and there was such **a** large amount of speculative homebuilding in the outlying areas that foreclosures activity in the outlying areas is far more intense than other states, except for maybe states such as Nevada, Arizona, and Florida. According to RealtyTrac, an online marketplace for foreclosure properties, there was **a** significant increase in foreclosures this year as compared to last year in these states.

At this point, personal residences make up the majority of foreclosures. People were buying houses with little or no money down, with loans that were adjustable after **a** certain amount of time. They are now coming due, interest rates are going up, the economy is going down, and jobs are being lost. Significant foreclosure activity on commercial property has not yet occurred. Our anticipation is that in coming years, it will be tougher for commercial property owners when their loans mature.

As for second homes, we are seeing many people who could afford second homes struggling right now. Those who have lost their jobs may be trying to sell those second homes and may have foreclosure trouble in the future.

An attorney considering expanding into this practice area in California needs to consider several things. The first and most important task is learning the California statutes and case law that are separate and distinct obligations from the loan documents that apply in foreclosure. The non-judicial world as well as the judicial world have very specific statutes on what people can and cannot do, and understanding the whole world of guarantees is very statutory specific and case specific. See, e.g., CAL. CIV. CODE § 2924 (West 2009); CAL. CIV. PROC. CODE § 580a-d (West 2009); CAL. CIV. PROC. CODE § 726 (West 2009). These statutes and case law have very specific notice requirements, time frames and anti-deficiency rights and obligations. Back in the 1990s, when we were doing **a** tremendous amount of foreclosure litigation, **a** lot of the case law was made because many cases were appealed. So dusting off your books and learning that law that was made in the 1990s during the last downturn is vital to be successful now.

We do not see people having much of **a** defense when the foreclosure is **a** simple non-payment type matter. Although there are exceptions, most of the time, the problem is that the borrower got in over her or his head and cannot make the payments. In **a** monetary situation, it is not likely that **a** borrower can enjoin the foreclosure sale. When foreclosure threatens, the more prudent homeowners are contacting the lender and trying to negotiate some sort of period of time to try to keep their home.

In California, most foreclosures are not judicially oriented; rather, the foreclosure is handled through **a** non-judicial trustee sale. Because of the non-judicial nature of the process, foreclosures have not had that much of an impact on the courts. This could all change if the loans secured by commercial property start defaulting as there will be **a** lot more receiverships and efforts to collect on the difference between the loan amount and the value of the real property security. Currently we are seeing more receivership activity than two years ago and we anticipate seeing **a** significant amount more next year. **A** receiver is appointed because of an application by **a** lender to take over **a** property, and the court decides it is **a** prudent thing to do pending the foreclosure sale.

I also see **a** lot more activity in the courts in connection with development projects that are in mid-stream. For example, we are currently working with **a** client who has completed construction but none of the condominiums have been sold. Our experience with the courts in foreclosure cases is that they are looking to protect the person or entity with the most money in the project. If there is **a** fight between partners, the court will most likely err on the side of (**a**) protecting the one who has the significant investment, (b) letting that person or entity take over and (c) letting the person with the smaller investment sue for damages.

Nowadays, many lawyers are claiming to be able to work out loan modifications for people. At the same time, many headlines proclaim those offers to be scams, so people have to be careful in terms of what they say in their advertising or what they promise their client and borrowers. As **a** lawyer, you can get involved in the foreclosure process if it requires documenting some sort of loan modification such as **a** payment plan. The more traditional way for **a** lawyer to get involved is in defending the person who is being foreclosed on by **a** more junior type lender. The need for **a** lawyer is analyzing whether there is **a** default, whether the lender has followed all of the requirements to foreclose, and whether there is **a** defense to the allegations of the lender.

For instance, the junior lender default situation can become complicated and legally intensive. Fights occur when development projects in mid-stream are taken over by **a** mezzanine lender or the passive equity that has the ability to vote out the managing member. The usual scenario is that the lender wants to take over the project and complete it and the borrower wants to argue that (**a**) the lender is going to do **a** worse job, (b) the lender will have an unsuccessful run at trying to sell these things and (c) it is much better for all parties to keep the original developer in place to complete the development project. An example of **a** situation we are currently dealing with is **a** project where the lender took over from the developer/construction company, hired **a** new construction company that went out of business, and now the project is worse off than it was before the default.

Strategic Planning

Negotiations are **a** key part of strategy in **a** foreclosure situation. Often lenders do not want the property/security back, so if you have clients who want to try to work something out and they just need some time, that is something lenders will usually listen to without having to go to litigation. If you tell the lender what is going to happen at trial during that first interview and self-mediate it without them stipulating to anything, that is the best way to get them to just come to the table now and work out what is the best thing to do. For instance, we have recently been involved in **a** matter where we were able to get the lender to agree to delay the foreclosure and work with the lender prior to completing the foreclosure.

Trying to deal with lenders who are under investigation or are having difficulties themselves

is an area where it is most difficult to try to negotiate. Trying to negotiate **a** deed in lieu is sometimes difficult because **a** lender may not perceive any benefit to **a** deed of lieu and may just want to try to wipe out any liens so there is **a** clean title. When you are facing that situation, it is difficult to negotiate with the lender.

Identifying the ultimate goal for your client is probably the top priority when you are in your first client meeting. Bring that up and brainstorm over all of the issues. The best use of **a** lawyer's time is identifying the goal and coming up with **a** plan to reach the goal. In order to be successful, **a** lawyer must have an understanding of the various factors that determine the goal, such as the client's financial condition, their emotional state in connection with this property and any other relevant factor that is unique to the individual situation.

Some of these goals could include not losing the house, working out **a** plan for payment, and minimizing the exposure. To sum it up, it is keeping the house, figuring out **a** way to give back the house without spending money, and minimizing the risk of **a** deficiency judgment.

Client interview questions need to bring you to **a** basic understanding of the nature of the circumstances in which they entered into the loan and what has been communicated since then. Have there been any prior communications with the lender about trying to do some sort of workout? Has the client admitted anything that can come back to haunt us? What efforts have been made to try to work things out prior to foreclosure? And when evaluating whether or not to try to enjoin **a** foreclosure when representing **a** borrower, find out what mistakes he perceives have been made by the lender in terms of calculating the dollar amounts owed, and are they being overly aggressive.

We have had success in helping clients dealing with junior lenders where the transition to those junior lenders has been handled smoothly because there is an alignment of interest of sorts, focusing on what it is that both parties need to go forward. Those parties are very sophisticated and understand the reality of the situation, and do not blame people for that. They try to come up with **a** win-win situation. We have been able to help clients transition properties to their lenders by lenders taking over the membership interests of the development entity, when they are in the middle of trying to sell condos. The potential buyers and the market itself do not perceive that they are buying foreclosed property. If they did, they would have trouble paying top dollar and would use that against the junior lender to try to negotiate **a** further discounted price. The bottom line is that avoiding **a** perception of foreclosure may help in future sales of the property. Pinpointing the joint goal where there is an alignment of interest and getting people to not blame and to understand the situation is where we can help in making this situation smoother and less painful than it otherwise could be.

Most important to **a** foreclosure defense and strategy is getting all the loan documents and understanding what rights people have, whether it be securities, unsecured, seeing whether or not there are guarantees and whether or not there is **a** right to seek **a** deficiency judgment. You need to take all those into account before advising clients.

In devising strategy, we commonly use two different types of experts. The first is someone who can interpret technical terms in loan documents, either **a** lender expert or **a** lawyer. They are very helpful for **a** judge who is not experienced in the financial world, and there are technical terms the court may not understand. The other type of expert relates to custom and practice in the industry, and whether or not there has been **a** breach of the loan documents. The most recent experience we had was with the rate lock agreement and understanding what the lender could and could not do when someone put **a** deposit for **a** rate lock. In that situation, the expert spoke of what the custom in the industry was, how the lender should have acted in that specific circumstance and why the actions of the lender in our particular circumstance constituted **a** breach of the loan documents.

Our most helpful resources in preparing for **a** case include our form file of previous pleadings and legal memorandum that we have been meticulously keeping since the 1980s. Second, there

are some great resource books that are dedicated solely to real estate finance areas, such as those published by CEB. Third, staying on top of current cases published each day by the daily journal is incredibly important because every day there is some new case we can use in our defense of **a** borrower.

From **a** business perspective, **a** common mistake attorneys need to avoid is not understanding what is entailed in taking on **a** matter involving complicated real estate finance principles. Another major mistake is not understanding the goal of the client on the front end and going down the wrong path, while yet another is not doing your due diligence from **a** legal perspective, understanding what law applies from the beginning, so you do not make mistakes that could cost the client even more money. It goes without saying that **a** lawyer can avoid these mistakes by doing the appropriate investigation and due diligence in the early phases of the engagement.

A common client mistake is unrealistic expectations. Lawyers need to deal with client's up-front expectations to avoid problems in the future. You have to be up front with **a** client and tell it like it is. If you are in **a** position where you have enough work as **a** lawyer, the last thing you want is **a** client who will blame you for his problems, so it is important to be up front from the beginning. If you know this area of law, you should be able to give **a** lot of the pros and cons and worst-case scenarios to that client and try to avoid clients that insist on the impossible.

Getting the lenders' perspective on things after you have heard your clients' side of the story is the best way to get warning signs of impending problems or pitfalls in the case. The biggest warning sign is when the lender has the exact opposite story the client has. Some recent case law holds that anything oral is just not relevant, due to the statute of frauds. So any time **a** client is relying solely on oral statements and you have **a** lender who says the opposite or is going to enforce his rights under the written agreement, that is when you know you have some problems with your case on the defense side. If this is the best evidence the client has, it may be wise to encourage settlement early in the case.

It is anybody's guess where the economy is going from here. Our guess is that it will get **a** bit rougher on the housing market for **a** while and **a** lot harder on the commercial side, once people have to try to refinance their commercial properties and the lending community is not there to lend at the same debt to ratio equity as they were in the past. I hope this is different from the 1990s. In the 1990s, we did not have the benefit of such huge databases and lenders were not necessarily aware of what problems they had nearly as fast as they are now. Hopefully, they are dealing with all the foreclosures fast, and hopefully, it will be over **a** lot sooner than in the 1990s.

From **a** legal perspective, our involvement will be more in the commercial projects and less in the residential foreclosures, just because of the amount at stake and the uniqueness of the borrowers in those particular situations. In the commercial context, the challenges the borrower's face are much higher stakes, much more equity investments, and more complicated legal issues when dealing with **a** project that has multiple lenders and equity partners and **a** lot more guarantees. In the residential world, there are far less guarantees and far less exposure to deficiency judgments, which lends itself to **a** quick response by **a** lender and less defense by **a** borrower.

Attorneys can prepare for these developing trends by just reading the newspapers, the daily journal on the new cases and where things are going, staying on top with the community itself and understanding the way the market is going. The more you educate yourself as to where the clients are and who is doing what, who is going to survive these tough times and who has creative strategies to do that, will be the best way to stay abreast of where you need to be for the future.

FNa1. *Real estate and construction litigator and trial lawyer Dan Goodkin has recently formed his own consulting and law firm practice after **a** year's stint as principal and general counsel with **a** major national developer, **a** client he had previously served as litigation counsel*.

Mr. Goodkin's extensive experience and in-depth expertise in all aspects of real estate litigation, dispute resolution, contracts, risk management, and insurance provide his clients with the capabilities to manage all risk for real estate businesses in the most cost-effective way. Specifically, Mr. Goodkin has litigated and tried real estate cases involving purchase and sale agreements, broker disputes, landlord-tenant disputes, real estate finance and partnership issues, construction and homeowner association disputes, complex bankruptcy issues, and environmental contamination and air remediation issues. In all of these cases, he provided consultation to his clients to develop strategies for underlying claims, review and analysis of insurance policies for defense and indemnity obligations, and negotiation and/or litigation regarding coverage issues.

Mr. Goodkin focuses on managing all risks naturally arising from contracts used during the real estate process to attempt to avoid litigation for his clients from the beginning of projects, and managing compliance with all insurance policies. As general counsel, he obtained unique insight into "big-picture" risk-management policies. Mr. Goodkin's strategy is based upon his "litigation waterfall" concept, which involves ***a*** *careful examination of every contract from the perspective of any and all claims from third parties, partners, and any others, making sure that all contracts work together as one enterprise*.

Mr. Goodkin is also currently focusing on (***a****) construction defect risk management and litigation, including new risks associated with the California legislature's passage of the right to repair law otherwise known as SB800, and (b) structuring insurance and risk management policies and procedure programs for all real estate types, including retail, commercial and multifamily development projects. His expert knowledge of SB800 is an important asset for Mr. Goodkin's developer clients seeking to prevent or manage construction defect litigation risks as much as possible*.

With ***a*** *successful legal career entirely focused on real estate and construction litigation, Mr. Goodkin has represented many large and significant institutional real estate clients. Additionally, he has recently co-wrote* ***a*** *book published by CEB titled* Easements and Boundaries: Law and Litigation*, and has been cited in the* California Real Estate Journal *as an expert on mold and its impact on commercial real estate buildings*.

Mr. Goodkin has been voted one of Southern California "Super Lawyers" in ***a*** *poll conducted by* Los Angeles Magazine*. He currently serves on the Executive Committee of the Real Estate Section of the Los Angeles County Bar Association and was previously chair of the Construction Subsection for two years. Mr. Goodkin also served as assistant chair of the USC/LACBA Benjamin S. Crocker Symposium on Real Estate and Business 2004, and as* ***a*** *judge pro tem for the Los Angeles Superior Court*.

In demand as ***a*** *speaker to trade organizations and bar associations on real estate and construction related issues, Mr. Goodkin has also delivered many seminars on construction insurance and risk management strategies, real estate finance litigation, bankruptcy issues, design/build construction, litigation strategies with respect to mold litigation, complex litigation, landlord-tenant disputes, easement and boundary disputes, and other advanced real estate topics*.

Mr. Goodkin attended Claremont Men's College and the University of California, Los Angeles, where he earned his B.A., and holds ***a*** *Juris Doctorate degree from Loyola Marymount University*.

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