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“Lenders repossessed 84,375 California houses and condos in 2007, up more than sixfold from 12,672 in 2006.”

Equity Home Sales Bond Requirements**THIS ISSUE**

Home Equity Sales involve a number of statutory requirements. But a recent court decision has potentially eliminated the bond requirement we discussed in the June 2007 R.E.A.C.H. issue.¹

LEGISLATIVE BACKGROUND

The implosion of the sub-prime mortgage market has kept the issue of residential foreclosures and the corresponding issue of Equity Home Sales in the forefront of the news. We discussed the issue of Equity Home Sales in the June 2007 issue of R.E.A.C.H. In that issue we said “we have seen headlines across the country decrying the spectacular increase in foreclosures on residential real property. The primary focus seems to be on sub-prime loans – made to low- or very low-income individuals, with low introductory rates and high back-end risks. As reported on May 31, 2007 by ABC News, residential foreclosures in California are up 65% over last year, and there is currently one foreclosure for every 400 homes in California. At least one industry analyst predicts that the loss of homes in foreclosures will far exceed what we saw in the Great Depression.”

Since that time home foreclosures have steadily increased. As reported in the San Francisco Chronicle, “Lenders repossessed 84,375 California houses and condos in 2007, up more than sixfold from 12,672 in 2006 In the fourth quarter, 31,676 residences in California were foreclosed upon. That was a 421.2 percent increase from 6,078 in the year-ago quarter. In the Bay Area, a total of 11,530 homes were lost to foreclosure in 2007, almost seven times the 1,651 foreclosures in 2006.”²

¹ *Equity Purchase Issues and Risks for Buyers and Brokers*, Vol. III, Issue No. 6, June 2007

² *Startling Jump in California Foreclosures*, Carolyn Said, San Francisco Chronicle, January 22, 2008.

The California Legislature created a statutory scheme to address what was called the unscrupulous buying practice of purchasing a home in foreclosure. The court of appeal summed up the Act saying “The Home Equity Sales Contracts Act was enacted to protect homeowners faced with mortgage foreclosure proceedings from being victimized by persons employing oral and written misrepresentations, intimidation, and other unreasonable commercial practices to induce the homeowners to sell their homes for a fraction of their fair market values and lose the equity in the home.” The Equity Act imposed licensing and bonding requirements on (and disclosures by) the representatives of home-buying companies.

FACTUAL SCENARIO

The Equity Act has been recently challenged at the appellate level.³ In that case, a homeowner was 13 months behind in payments and in foreclosure when she was approached by a commercial home investment company that offered to reinstate her loan and pay her some cash value for her home. In addition, the company offered to allow her to remain in the home after close of escrow on a lease through the beginning of January 2004.

At the end of her lease, the seller did not leave, and the buyer sued in unlawful detainer to have her evicted from the home. The seller brought a separate action against the buyer to undo the transaction. The complaint alleged the purchase contract was voidable because the buyer did not provide proof of bonding, because it did not provide adequate notice of the right to cancel, and because it was unconscionable. At trial, the court rejected the seller’s arguments that the contract was rescindable because of inadequate notice of the seller’s right to cancel or because of unconscionability. But the court ruled the deed could be canceled for noncompliance with the bond requirement of section 1695.17.

³ *Schweitzer v. Westminster Investments* (2007)

The buyer appealed the decision, arguing, among other things, that the bonding requirement was unconstitutionally vague.

IN BRIEF

A statute is void for vagueness if persons of common intelligence must guess as to its meaning and differ as to its applications. The void-for-vagueness doctrine reflects the principle that a statute that either forbids or requires the doing of an act in terms so vague that people of common intelligence must necessarily guess at its meaning and differ as to its application, violates the first essential element of due process of law. The requirement for certainty in statutes reduces the danger of caprice and discrimination in the administration of the laws, enables individuals to conform their conduct to the requirements of law, and permits meaningful judicial review.

The statute does not specify the total amount of the bond required by the statute. The appellate court found that there are two conflicting interpretations as to the amount of the bond. The first interpretation is that the representative must prove that he or she has a separate bond for each transaction in an amount equal to at least twice the fair market value of the home subject to that transaction. The alternative interpretation is that a representative may conduct multiple transactions under the umbrella of a single “blanket” bond as long as the blanket bond is at least twice the amount of the fair market value of the real property on any individual transaction. Neither the text of the statute nor the accompanying legislative history provides guidance to determine the legislative intent regarding the amount of the bond, and there are no administrative rulings or regulations addressing this issue.

The court of appeal recognized that individualized bonds would be unreasonable or impractical. However, although this interpretation (in favor of a blanket bond) may rely on sound *economic*

considerations, that interpretation is untethered to any *statutory language* and could be contrary to the text of section 1695.17, subdivision (a)(1), because the language of that subdivision defines the *amount* of the bond by reference to the *individual transaction* for which it is proffered.

And the court found the statute to be vague in other ways as well. Even if the court speculated (based on economic considerations extraneous to statutory language or legislative history) that a blanket bond would satisfy the statute, the statute would still be devoid of adequate notice of other essential elements of a bond that would guide a representative to know what bond would comply with the statute. Section 1695.17 requires the representative be “bonded” without identifying who is to be the obligee on the bond. Unlike as with other statutory bonds, a representative of an equity purchaser seeking to comply with section 1695.17 must speculate whether the bond is to identify the obligee on the bond as the individual home equity seller, or the State of California, or some other undefined obligee.

The court also found that the conditions on and beneficiaries of the bond are undefined and the delivery or posting requirements are unidentified.

As the court concluded, “We are convinced that the amorphous requirement of section 1695.17, requiring proof the representative is ‘bonded by an admitted surety insurer in an amount equal to twice the fair market value of the real property which is the subject of the contract,’ provides no guidance on the amount, the obligee, the beneficiaries, the terms or conditions of the bond, the delivery and acceptance requirements, or the enforcement mechanisms of the required bond. Instead, persons of ordinary intelligence must necessarily guess at what the statute requires for them to comply with its obligations. Under these

circumstances, the bond requirement of section 1695.17 is void for vagueness under the due process clause and may not be enforced.”

What does all this mean?

On a practical level, the bonding requirement of the Equity Act was held to be unconstitutionally vague. Until and unless the legislature modifies the statute to correct these inadequacies, the bond requirement cannot be enforced.

The conclusion of the court is important, because it does not say that the entire statute is unenforceable, only that the bonding requirement is unenforceable. At least for now, the remainder of the statute must be complied with.

CONCLUSION

For many years, the Equity Act has been criticized as being unconstitutionally vague among many other things. There is now an appellate decision supporting that criticism. But that does not mean that equity purchasers are free to ignore the Act altogether. While it may be that future court decisions will further erode the strength of the Act, it remains, at least for now, enforceable in all aspects other than the bond requirement. And the ramifications of failing to comply with the law can be quite severe, including the unwinding of a transaction years later. In a rising real estate market, this could put considerable pressure on an equity purchaser who did not comply with all of the required elements of the statute

NEXT ISSUE

Seeking prevailing party attorney’s fees in real estate court actions or arbitrations.

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