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hearsay!

The Law Offices of Hemar, Rousso & Heald, LLP

MAKING OUR MARK FOR MORE THAN 30 YEARS

Sidebar

The fall season always arrives with a brisk chill at night to complement our balmy California sunshine. The current economic climate is also changing, and the mortgage crisis is having a wide impact on our clients. Bankruptcy filings are on the rise. This issue draws attention to how lenders can better prevent unfortunate results in bankruptcy court through use of tighter loan guidelines. And to tickle your funny bone, we share a wonderful war story in which a "professional debtor" gets his comeuppance. Enjoy!

– Martin J. Rousso

In this Issue

Poetic Justice for a Professional Debtor
(A War Story)

Occasionally a debtor rubs me the wrong way, although not all, of course. Most of the people and businesses that come across my desk have fallen upon hard times due to bad investments, loss of work or a change in the economy. The ones that get under my skin a bit are those that intentionally and deceitfully live beyond their means and then try to cover their tracks through legal shenanigans. Back when I worked in the collections department at a large bank we referred to such people as "professional debtors."

John Morgan (not his real name) was a professional debtor. Our client originally entered judgment against Morgan in Washington State because Morgan entered into a business transaction there and then skipped town. Morgan paid no heed to the judgment because he had no assets in Washington and, according to him anyway, very few anywhere else.

"What happened to the large Rolex that up until a few minutes ago was on your left wrist?" He paused, smiled slyly, and said, "Oh, I must have lost it."

When the file arrived on my desk, the client's instructions were to domesticate the $150,000.00 Washington judgment in California and then do all I could to pursue Morgan and his, supposedly, nominal assets.

Entering judgment was easy. I spoke to Morgan's attorney once or twice. Like his client he had paid little attention to the Washington judgment and seemed little concerned about a California judgment. "My client has no assets in California," he said. "He is judgment proof." Blah, blah, blah. He did, however, mention one thing that got my attention. He said Morgan's only income came from a family trust.

Wanting to learn more about his source of income I served him with an order to appear for a judgment debtor examination and with a subpoena to bring all kinds of documents, including the documents which established the family trust. Once served, I again received a call from his attorney. "You have a lot of gall pursuing my client!" he cried. "As an officer of the court I am telling you he has no assets!" More blah, blah, blah. The words from *Hamlet* came to mind: "Me thinks [he] doth protest too much." If there were truly no assets, why the big fuss?

At the debtor examination I asked many of the typical questions about bank accounts and employment. He claimed to be unemployed, although he said he did some occasional consulting for a friend. I asked him about his residence. He gave me an address on Balboa Island, but said he paid no rent because his same good friend let him live there free of charge. As I was taking notes, I noticed a huge white band of bare skin

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Poetic Justice
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around Morgan's deeply tanned left wrist. "Do you have any jewelry, Mr. Morgan?" I asked. "No," he said, "I don't have any jewelry." I then asked, "What happened to the large Rolex that up until a few minutes ago was on your left wrist?" He paused for a moment, smiled slyly, and said, "Oh, I must have lost it." His smile conveyed one additional statement: "You will never collect a dime."

Back at the office I went over the documents he had provided, and I did a bit of research. It was true that he lived at an address that he did not own. His friend, however, must have been a very good friend because the house was worth about $4 million. I also noticed that the Morgan Family Trust owned a two-bedroom house in Newport Beach. Although small, it was right on the beach and worth in the range of $2.5 million. Not too shabby for a two-bedroom cottage.

Because I had already recorded an abstract of judgment, thereby placing a lien on the real property, I consulted with my client, and we decided to levy on the real property.

Such a levy is not especially difficult, but the filing and timing of the many legal documents involved is fairly exacting. Once the process begins, things happen swiftly. But, having done our homework, we sent the paperwork off to court and out to be served. Inasmuch as Morgan did not live at the property, certain legal protections did not apply, and the sales process was streamlined somewhat. Because, as I discovered, Morgan's adult children did live at the cozy beachfront cottage, there would probably be a significant amount of family pressure to resolve the matter prior to a forced sale. Potentially complicating things though, was that the owner of the real property was the family trust and not Morgan.

It was during that time that I developed quite the professional relationship with Morgan's attorney. He would call me once a day or so to berate me for my incompetence and to lecture me on what a trust was, and how since the property was in a trust my client could not foreclose. I would try and explain, as politely as possible, that I disagreed with his assessment, but that the entire matter could be easily resolved if his client would simply pay my client what it was owed.

The calls continued, though, until the matter finally went to court for the hearing on whether we could levy and sell the real property.

Morgan's argument, through his attorney, was essentially this: "The property doesn't belong to Mr. Morgan. It is an asset of a family trust and therefore the bank and its ignorant half-wit attorney can't foreclose."

My rebuttal was this: "First, the trust documents clearly show that the trust is a revocable trust, as opposed to an irrevocable trust. Therefore, Mr. Morgan maintains full power and decision-making authority over it. California law states quite clearly that assets of such trusts are available to creditors."

"Second, Mr. Morgan has made a big deal about the fact that the property is a trust asset as opposed to a personal asset. In fact, Mr. Morgan claims that on January 2, 2004, he placed the Newport Beach property in the Morgan Family Trust by use of a deed of trust. However, it is factually impossible for this deed of trust to have been signed on January 2, 2004. If the court will look at bottom right hand side of the deed of trust, the court will see the notation, 'sfdot rev. (03/18/05).' Such notations are common on various legal forms now in use. That notation would be commonly understood to mean, 'Short form deed of trust revised March 18, 2005.' In other words, even though the deed of trust was supposedly signed on January 2, 2004, **the form did not even exist until March of 2005**. By claiming otherwise, Mr. Morgan has tried to defraud his creditors and this court."

It is not often that such a blatant lie is exposed in open court. Thus, the court quickly agreed that Morgan was a lying scallywag, and the sale of the real property could proceed.

Not long afterward — and before the sale of the $2.5 million Newport Beach shack — our client was paid in full.

I think the legal term for that is, "Gotcha."

— Robert V. McKendrick

HRH's Newest Partner

Wayne R. Terry

On August 4, 2008, Wayne R. Terry became a partner of the firm. As Richard Hemar said in making the announcement, "Since arriving from his previous firm, where he was also a partner, Wayne has offered valued contributions in a variety of areas and we hope you will join us in welcoming him in this new position."

Ouch! – Bank Gets No Pain Relief

The following case is a painful lesson for a large bank that failed to do its homework during the loan application process. Although mortgage fraud was found, the bank received little sympathy — or relief — from the bankruptcy judge, and the debt was ruled discharged. The case is *In re Hill* and it was published as a slip opinion by the U.S. Bankruptcy Court for the Northern District of California.

Background

The debtors purchased their home more than 20 years ago. Over the years, as their home's value increased, the debtors refinanced their original loan and later obtained an equity line of credit from the bank in the amount of $200,000.00, which was subsequently increased to $250,000.00. The debtors employed a loan broker to refinance their loans except for the latter increase in their credit line, which was done directly with the bank. Inevitably, the debtors cashed out the entire equity line. With the downturn in the real estate market, they could no longer afford their mortgage payments and filed a Chapter 7 bankruptcy.

Discussion

The bank filed an adversary proceeding to prevent its debt from being discharged, based on 11 U.S.C. §523(a)(2)(B), alleging that the debtors obtained their line of credit by fraudulently misrepresenting their income.

The loan broker who had represented debtors in five prior refinance transactions was called as a witness at trial. He testified that the debtors had previously provided him with their overstated income figures, which were used for the requisite loan application for each refinance, and that the debtors were aware of those figures when their signed their loan applications. The court did not believe the debtors' purported lack of knowledge of the inflated income figures. A critical fact was that the debtors had personally negotiated the most current credit line increase with the bank and provided those figures themselves. Although they claimed to be making a combined income of $150,000.00 per year on the application, the court determined it was probably closer to $65,000.00.

The district manager for the lender testified that the debtors' loan was a "stated income" loan, which did not require verification of debtors' income. The lender's loan approval guidelines required that the debtors' employment, not their income, be verified, and further required that a third-party verify the reasonableness of the debtors' stated income — not its amount. In this case, the debtors' employment was verified by accepting a Certified Public Accountant's letter attesting to the existence of the debtors' business. The CPA letter, however, was signed by someone different than the CPA whose name was on the letterhead. The lender provided evidence that it had verified the CPA's name, but it failed to show that it had ever verified the identity and credentials of the person who signed the letter. The bank manager also testified that the remaining loan approval guidelines, such as the minimum FICO score, appraised value and loan-to-value ratio, had been met in this case.

Findings

The court found that the debtors had, in fact, knowingly misrepresented their incomes and that such misrepresentation was material and with the intent of deceiving the bank. But in a stunning turn of events, the court nonetheless ruled *against* the bank and discharged the debt. It found that the bank's reliance on the debtors' financial statements was not objectively reasonable. In the court's view, the bank should have delved deeper into the debtors' creditworthiness because numerous red flags existed on the loan application. These included the dubious authenticity of the CPA letter, and a troubling fact: the debtors' stated income figures were wildly different from those just six months earlier.

Lastly, the court "surmised" that the lender probably made the loan based on the value of the debtors' home — not their income — because only minimal income verification was required under the bank's guidelines. The court questioned the reasonableness of those guidelines. This weighed heavily against the lender.

Conclusion

The court called this case "a poster child for some of the practices that have led to the current crisis in our housing market." This decision is a cautionary tale in these uncertain times for the mortgage industry. It confirms that the bankruptcy courts in California, though unwilling to condone a debtor's blatant fraud, are just as unwilling to hold in favor of a lender if that institution might arguably share the blame for its own loss.

With the recent rise in personal Chapter 7 bankruptcies, we anticipate further interesting legal scenarios will arise, and we, at HRH, will continue to keep you apprised of them.

— Raffi Khatchadourian

HRH Happenings

Hemar, Rousso & Heald Is Pleased to Announce the Addition of These New Associates

David M. Kritzer

David M. Kritzer is the newest attorney to come to HRH. David is a transplanted New Yorker whose family moved to California before his eighth birthday.

David attended and graduated from the University of California, San Diego. He received his law degree from Pepperdine University of Law School in Malibu, where, in addition to enjoying the wonderful climate students can spot an occasional celebrity or brush fire.

David was admitted to the California Bar in 1994 and has been working in the areas of civil litigation, consumer law and collection law ever since. Away from the office, David enjoys spending time with his wife and two sons, and collecting sports memorabilia.

Edward S. Kim

Edward S. Kim is a recent addition to the HRH family. Edward received his bachelor's degree from the University of California, San Diego, and then his law degree from Loyola Law School in 2006. He is also a graduate from the Platoon Leader's Program for the U. S. Marine Corps in Quantico, Virginia.

In addition to raising his 2 ½-year-old and five-month-old daughters with his wife, Edward is a certified divemaster for SCUBA and is looking to try the Ironman Triathlon next year.

Matthew R. Rungaitis

Matthew R. Rungaitis enjoys a distinguished and varied career. In addition to his expertise in commercial litigation, Matthew has worked in the fields of elder abuse and medical malpractice. He graduated from McGeorge Law School after receiving his Bachelor's degree from the University of Minnesota. He is licensed to practice law in both California and Arizona.

A Los Angeles native, Matthew says he has, "moved around a lot," spending years overseas in London, up north in Sacramento, and in lake-filled Minnesota before returning to Los Angeles. When not spending time with his six-year-old daughter, Matthew is an avid SCUBA diver.

Other New Arrivals

HRH welcomes legal assistants Sanaz Adnani, Cristina Gonzalez, Maryann Granzow, Blanca Gutierrez, Patty Maher, Kim Shepard, accounting clerk Pat Trent, billing clerk Lauren West, collector Nelson Lee, and receptionist Cindy Herrera.

Irwin Wittlin Speaks at UAEL Conferences

Associate Irwin M. Wittlin has continued his active role in the United Association of Equipment Leasing ("UAEL"). Irwin continues to serve on the board of directors in addition to actively participating in the UAEL's Educational and Legal Committee. At the Spring Educational Conference in Napa, Irwin was invited to participate on a legal panel discussing selected issues, including lease collections, lease law and equipment recovery. Irwin's continuing efforts did not go unnoticed by the association, and in July Irwin was selected as the UAEL Volunteer of the Month. At the recent Fall Annual Conference, Irwin's presentation on lease law was videotaped and will soon be made available online to all UAEL members.

One Arrival by Stork — Andrew

Associate Jeannine Del Monte-Kowal is the proud mother of Andrew Thomas Kowal. He was born, two weeks early, on April 14. Jeannine and her husband Jerry are both convinced Andrew is the cutest baby in the world.

The Law Offices of Hemar, Rousso & Heald, LLP 15910 Ventura Blvd., 12th Floor, Encino, CA 91436, 818/501-3800, FAX 818/501-2985. The firm specializes in the fields of commercial and consumer litigation, collections, bankruptcy and general corporate matters. Individual lecturers on the topics contained herein, as well as others on request.