

**PRACTICE LAW, LOSE YOUR LICENSE:
WHAT SB 94 MEANS TO YOUR PRACTICE**

By Alice M. Graham

“The first thing we do, let’s kill all the lawyers.”¹

Most of us like to think we are honest, reputable and diligent in representing our clients. For those of us in private practice with the responsibility of running a business, we must also be prudent about being compensated for our services. Attorneys have nothing to sell but our time. However, the ability to practice law as we knew it and collect fees as we would have it has been altered by recent legislation and State Bar decree, at least with regard to loan modification.

The recent collapse of the real estate and financial markets in this country created the need for attorneys to help many of their homeowner clients by negotiating with lenders for a forbearance or modification of loans secured by the clients’ homes. “Loan mod” became the issue of the day.

Much as our federal legislators appeared dumbstruck by the confusing new inventory of the banking industry (what are asset backed mortgages, and who does own the note?) which led to the fall of our entire financial sector, individual homeowners who were routinely told not to worry about their ever-increasing mortgages finally hit the wall of upside down loans that could not be repaid or refinanced. Homeowners whose loans adjusted to a higher rate, or who lost their jobs or became ill, people who could not refinance anymore or sell their homes because the lender would not accept less than the full amount of principal, interest and penalty due, turned to their attorneys for help.

Unfortunately, not all of the attorneys were helpful. Some saw amidst all the fear and confusion an opportunity to make a buck without doing a thing. The press began to report bogus loan modification firms, some of which including attorneys, that were taking fees from the unsuspecting public and then essentially doing nothing. The State Bar investigated. Licenses were forfeited.

To put a stop to those who were taking advantage of vulnerable homeowners, the California legislature enacted Senate Bill No 94, which was passed as an emergency measure and became effective October 11, 2009.

California Senate Bill 94 amends Sections 10026, 10085, 10133.1, and 10177 of the Business and Professions Code; adds or amends Sections 6106.3, 10147.6 and 10085.6 of the Business

¹ Shakespeare, Henry VI Part 2, Act 4, Scene 2, 71-78, spoken by Dick the Butcher.

and Professions Code; adds or amends Sections 2945.1, 2944.6 and 2944.7 of the Civil Code, and amends Section 22161 of the Financial Code, relating to mortgage loans.

Civil Code Section 2944.7 is of particular interest. It provides, in relevant part:

(a) Notwithstanding any other provision of law, it shall be unlawful for any person who negotiates, attempts to negotiate, arranges, attempts to arrange, or otherwise offers to perform a mortgage loan modification or other form of mortgage loan forbearance for a fee or other compensation paid by the borrower, to do any of the following:

(1) Claim, demand, charge, collect, or receive any compensation until after the person has fully performed each and every service the person contracted to perform or represented that he or she would perform...

(b) A violation of this section by a natural person is a public offense punishable by a fine not exceeding ten thousand dollars (\$10,000), by imprisonment in the county jail for a term not to exceed one year, or by both that fine and imprisonment, or if by a business entity, the violation is punishable by a fine not exceeding fifty thousand dollars (\$50,000). These penalties are cumulative to any other remedies or penalties provided by law...

(d) This section shall apply only to mortgages and deeds of trust secured by residential real property containing four or fewer dwelling units.

This statute applies to “any person”, including attorneys. The statute makes it illegal to receive any compensation for work arranging a loan modification or loan forbearance on behalf of an owner of residential real property containing four or fewer dwelling units. The statute does not define loan modification or forbearance.²

With the passage of SB 94, it is now illegal to practice law for compensation, if your practice is negotiating or arranging loan modifications or forbearances. You must finish the job, then bill the client and hope to be paid. You may not collect any advance fee, not even a retainer to be held in trust.

Also affecting attorneys’ ability to represent clients in this area is new Civil Code Section 2944.6. This section requires you to notify your client that your client does not need you. It provides in relevant part:

² We understand loan modification to mean a revision of the loan documents to provide more favorable terms for the borrower, such as reduced interest or principal. We understand forbearance to mean the lender’s agreement to “forbear” from foreclosing by agreeing to vary the terms of the loan so that the borrower will presumably be able to continue making payments.

(a) Notwithstanding any other provision of law, any person who negotiates, attempts to negotiate, arranges, attempts to arrange, or otherwise offers to perform a mortgage loan modification or other form of mortgage loan forbearance for a fee or other compensation paid by the borrower, shall provide the following to the borrower, as a separate statement, in not less than 14-point bold type, prior to entering into any fee agreement with the borrower:

It is not necessary to pay a third party to arrange for a loan modification or other form of forbearance from your mortgage lender or servicer. You may call your lender directly to ask for a change in your loan terms. Nonprofit housing counseling agencies also offer these and other forms of borrower assistance free of charge. A list of nonprofit housing counseling agencies approved by the United States Department of Housing and Urban Development (HUD) is available from your local HUD office or by visiting www.hud.gov.

(b) If loan modification or other mortgage loan forbearance services are offered or negotiated in one of the languages set forth in Section 1632, a translated copy of the statement in subdivision (a) shall be provided to the borrower in that foreign language.

(c) A violation of this section by a natural person is a public offense punishable by a fine not exceeding ten thousand dollars (\$10,000), by imprisonment in the county jail for a term not to exceed one year, or by both that fine and imprisonment, or if by a business entity, the violation is punishable by a fine not exceeding fifty thousand dollars (\$50,000). These penalties are cumulative to any other remedies or penalties provided by law.

At first blush, this statute might seem a sensible response to the abuses that led to its debut. However, it is misleading. The required disclosure falsely gives an impression that this work is just as easily a do-it-yourself endeavor, like applying for a social security card or a fishing permit. No one is required to have an attorney with very few exceptions (corporations cannot represent themselves). However, to inform a client that “it is not necessary” to hire a lawyer to do legal work is to devalue the reason a client hires a lawyer in the first place: for his/her knowledge and expertise. Clients are free to represent themselves in contract negotiations and litigation too. But is this a wise thing to encourage? Is it honest to even imply a potential client might do just as well representing him/herself? A doctor might tell you that you can operate on yourself, but you are likely to get very hurt.

It is misleading to tell a client that the client can negotiate a loan modification on his/her own because loan modifications are difficult to obtain. Lenders are notoriously unhelpful in dealing with their borrowers, once the funds have traded hands and the borrower seeks relief. The general public is often naïve about the simplest of steps, such as documenting who you spoke to and what they said. Clients who have lost their home have come to meet with an attorney many a time saying, “but they said they wouldn’t foreclose...” There is nothing in

writing, and the client does not even know the name of the person they spoke with. The public comes to lawyers for help because the public does not have the ability to negotiate with a powerful and knowledgeable adversary, the bank.

Many think it is the banks who put the public in the current situation. During the heyday of a bullish rising market, lenders were delighted to make no-documentation loans to anyone with a house and a pulse—and sometimes even less than that. However, no one has passed a law that banks cannot hire lawyers, or that their lawyers cannot be paid. To the unsuspecting Mr. or Ms. Public who takes the Section 2944.6 notice to heart, they will be dealt with by lenders that are fully supported and advised by counsel of their choosing. The lender's attorneys have no restriction upon them affecting their ability to be paid for work performed.

Of course, the new legislation does not preclude payment of attorneys outright. After all the work is performed, the attorney can then ask the client to be paid. More often than not, the client has no or little resources, which is why the client consulted the attorney with this particular problem in the first place. These are not contingency cases that generate funds at the conclusion of the process. This is not a realistic, workable scheme for most attorneys who must support themselves with their earnings. Attorneys taking on loan modification or loan forbearance work may be de facto accepting pro bono assignments. We didn't start the fire, but we are being tasked with putting it out.

Utilizing a nonprofit agency is not necessarily a viable alternative for everyone. Anecdotally, the nonprofits have a much lower percentage of successful loan modifications than private attorneys. Many people perceive the value of hiring a private business instead of utilizing nonprofit or government agencies to obtain more personal attention and overall better results.

The limitation that attorneys can only be paid after all the work is done is tantamount to a lender making a 30-year loan, and not being allowed to collect any interest or principal payments until the thirty years are up. Do you think there would be an outcry from the banks? Would there be another bailout? Do you think anyone will bail out consumers' attorneys when they are not paid for working to obtain loan modifications or forbearance?

Prior to SB 94, Division 3, Part 4, Title 14, Chapter 2 of the Civil Code contained legislation in Article 1.5 regulating "Mortgage Foreclosure Consultants at CC §2945 et seq. The article excluded and still excludes attorneys from its provisions, per Civil Code Section 2945.1. The new Civil Code section 2944.7 is not part of the Mortgage Foreclosure Consultant statutory scheme. Instead, the new statute was added to Article 1, Mortgages in General. It is aimed at attorneys.

In addition to the draconian punishment mandated by Civil Code Section 2944.7 for the "crime" of getting paid for services rendered—penalties of a fine up to \$10,000.00 and imprisonment for up to a year, or both, there are additional penalties for attorneys. New Business and Professions Code Section 6106.3 also makes it a cause for imposition of discipline for an attorney to engage in any conduct in violation of Section 2944.6 or 2944.7. This statute is in effect until January 1, 2013. Commencing January 1, 2013, the statute omits reference to

Civil Code Section 2944.7 (giving notice to the client). The Section 2944.6 prohibition against getting paid remains.

Some attorneys have privately wondered whether it is possible to break up services so that the attorney can charge for each service as completed, such as draft a letter to the lender, and collect a fee. Negotiate by telephone, and collect a fee. Draft a separate retainer for each step. The State Bar has not announced a position on this issue. However, the shrill language of Section 2944.7(a)(1) precludes an attorney from accepting a fee “until after the person has fully performed each and every service the person contracted to perform or represented that he or she would perform.” It would seem to violate the spirit of the law to break legal services down into a multitude of separate retainer agreements. You can be fined \$10,000, go to jail for a year, and lose your license if you guess wrong on this one. Proceed at your own risk.

Do not make the mistake of thinking that you can collect a retainer and place it in your client trust account. The California State Bar has interpreted the new statutes and has concluded the statutes forbid acceptance of even retainer funds to be held in trust. The State Bar opines as follows:³

2. Is it a violation of Civil Code Section 2944.7(a)(1) to collect an advance fee, place that fee into a client trust account, and not draw against that fee until the services have been fully performed?

Yes. The statutory language of the prohibition uses the word “receive” and the plain meaning of that term is broad enough to encompass a lawyer’s receipt of advance fees into a trust account. Civil Code Section 2944.7(a)(1) makes it unlawful to “collect, or receive any compensation until after the person has fully performed each and every service the person contracted to perform or represented that he or she would perform,” whether the compensation is placed into the lawyer’s client trust account, general account or any other type of account.

3. Is it a violation of Civil Code Section 2944.7(a)(1) to ask for or collect a “retainer”?

Civil Code Section 2944.7(a)(1) makes it unlawful to “[c]laim, demand, charge, collect, or receive any compensation until after the person has fully performed each and every service the person contracted to perform or represented that he or she would perform,” even if that compensation is called a “retainer.”

While we may have understood the legitimately strict rules regarding funds held in a trust account, those rules are now out the window. We all know that funds in a client trust account belong to the client. An attorney may not access those funds until work has been performed and billed. An attorney may not commingle his or her own funds with those of the client. But now, it is off limits to collect even a retainer in trust for certain kinds of work.

³ State Bar FAQs, calbar.ca.gov/calbar/pdfs/ethics/Ethics-SB94-FAQs.pdf. Question number one asks if CC §2944.7(a)(1) is retroactive. The State Bar’s interpretation is that any advance fees collected after October 11, 2009, even if the agreement was entered into prior to that date, must be refunded.

SB 94, with an assist from the State Bar, now precludes an attorney from depositing a retainer in a trust account for work to be performed to obtain a loan modification or forbearance. An attorney may not collect even a retainer to be deposited in a trust account for loan modification or forbearance related work.

The common wisdom is, SB 94 was a reaction to some bad apples who took people's money for loan modifications and absconded with the money. To do such a thing to people in need is despicable and should be dealt with accordingly. However, in this case, perhaps the legislature and State Bar have killed a fly with a demolition bomb. The fly is gone, but so is the house. Many more people, sadly, are bound to lose their homes as a result of SB 94 and the State Bar's interpretations.

Dick the Butcher, the character in Shakespeare's Henry VI Part 2 was a ne'er-do-well who had no idea why lawyers were always writing things down on their parchment. Dick was lucky he didn't have a mortgage he couldn't pay.