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HESCA: Can Your Rights Be Waived?

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This summer, the 9th Circuit Court of Appeals affirmed a District Court's ruling that a general release of Civil Code §1542, did not relinquish a home seller's rescission rights under the California Home Equity Sales Contracts Act ("HESCA", Cal. Civ. Code §1695 et seq.). *Hoffman, et al. v. Lloyd, et al.* 2009 U.S. App. LEXIS 15917.

In the midst of foreclosure, Lloyd sold his home to Hoffman, who then leased it back to him – commonly known as a "sale and leaseback" transaction. As the property was in foreclosure, HESCA applied, which was unfortunate for Hoffman because the sales contract failed to give Lloyd notice of his right to rescind within the time frame described in HESCA.

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HESCA's purpose is to "provide each homeowner with information necessary to make an informed and intelligent decision regarding the sale of his or her home to an equity purchaser." Cal. Civ. Code §1695(d)(1). To effectuate its purpose, HESCA obligates a buyer of property that is in foreclosure to provide to the seller, among other things, notice of the seller's right to rescind the sale contract. Cal. Civ. Code §§1695.4-1695.5(d).

Until a buyer adheres to the provisions of HESCA, the seller may cancel the sale contract. Cal. Civ. Code §1695.5(d). Evidencing a strong desire for adherence to HESCA's protections, the California legislature provides that "[a]ny waiver of the provisions of [HESCA] shall be void and unenforceable as contrary to the public policy." Cal. Civ. Code §1695.10.

When Lloyd defaulted on his lease payments, Hoffman filed an unlawful detainer action. The parties settled the unlawful detainer and as part of the settlement, Hoffman and Lloyd executed a mutual release agreement, which expressly waived the protections of Cal. Civil Code §1542, but made no mention of HESCA.

Back on an even keel, the lure of rough seas could not be resisted. Within months, Lloyd filed a Chapter 11 bankruptcy and on October 18, 2004, recorded a notice of rescission of the original sale agreement. Not one to take an offence lying down, Hoffman filed a state court suit seeking cancellation of the rescission, which was sucked into the drain of Lloyd's bankruptcy.

After conducting an evidentiary hearing and determining as a matter of fact that Lloyd was unaware of his HESCA rights

Continued on page 36

Inside This Issue

Featured Article

HESCA — *Continued from Page 1*

at the time of release, the bankruptcy court concluded that the general release did not apply to Lloyd's rights under HESCA. Because the right to rescind survives until compliance, Lloyd's rescission was, therefore, valid.

The district court affirmed but did not believe an evidentiary hearing was even necessary. The original sale did not comply with HESCA and the settlement did not waive any right under HESCA, Hoffman had no evidence to the contrary, and, thus, Lloyd's rescission was valid. Circuit Judge Schroeder's observation that HESCA's right to rescission cannot be waived suggests that the court may not have even needed to go that far.

How could the buyer have avoided this situation? Rather simply, by following the instructions of §1695.5 at the original sale, which conveniently provides the appropriate wording, location and point size for the waiver (in bold, of course).

Once, the lease-back was concluded, could Hoffman have salvaged the contract in the settlement of the unlawful detainer? Maybe, if the settlement included the specific notices from HESCA along with recitals that the parties had consulted with counsel and understood their rights and that the right to rescind was being given up. To the contrary, if it got up to the circuit court it was likely beyond salvation. Circuit Judge Schroeder never had to decide whether a knowing waiver of HESCA rights would have been valid but the fact that he cited its provision that "[a]ny waiver of the provisions of [HESCA] shall be void and unenforceable as contrary to the public policy," in the third paragraph of his opinion calls any waiver into question. His closing comments, while citing the lower court, are illustrative, "Any contrary result would undermine HESCA by permitting a purchaser to defeat the seller's right to rescind by first executing a sale contract without the required notices, and then executing a release purporting to extinguish any known and unknown claims….[t]his kind of backdoor loophole is inequitable and frustrates the purposes of HESCA."

Obviously, this case is a cautionary tale for real estate investors. Home equity purchasers are expected to be sophisticated. Buyers purchasing a property for their personal residence are specifically excepted from HESCA. Cal. Civil Code §1695.1(a)(1). Real estate investors should take this to heart as even more HESCA litigation can be reasonably anticipated especially if the subprime meltdown extends into the prime market. But this case goes beyond HESCA and belies a judicial enmity to general waivers. Do not expect the courts to be kind to a general waiver of "important statutory rights." In this case it was HESCA but consider the similar treatment of the Federal Truth-in-Lending Act in *Mills v. Home Equity Group, Inc.*, 871 F. Supp. 1482 (D.D.C. 1994).

No lawyer is going to delete his or her general waivers but the drafter should know that a §1542 waiver will be construed as narrowly as possible and when it comes up against a statute like HESCA it will almost certainly fail. And if you can expect a narrow reading from a state court judge just wait until it ends up before a bankruptcy judge.

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