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Consumer Protection

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Consumer Protection Measures for Homeowners Strengthened

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Code Sections Affected
Civil Code §§ 1695.4, 1695.5, 1695.6, 2945.3 and 2945.6 (amended).
AB 669 (Wright); 1997 STAT. Ch. 50
Civil Code § 2954.12 (enacted).
AB 1160 (Shelley); 1997 STAT. Ch. 65

Home ownership is an integral part of the American Dream.[1] For most homeowners, the home represents both their largest asset and the largest extension of credit that they will ever obtain.[2] The typical consumer does not possess extensive knowledge about the real estate market or home financing, and often defers judgment to more sophisticated intermediaries.[3] In order to protect the interests of unsophisticated homeowners in California, the Legislature has enacted Chapter 50 to strengthen both the Home Equity Sales Contracts Act (HESCA),[4] and the Mortgage Foreclosure Consultants Act (MFCA).[5] Additionally, Chapter 62 was enacted to strengthen consumer protection laws pertaining to cancellation of Private Mortgage Insurance (PMI), also referred to as "mortgage guarantee insurance."[6]

1. 143 CONG. REC. H1557-02, 1559 (daily ed. Apr. 16, 1997) (statement of Rep. Hansen) (explaining the advantages for homeowners of pending Congressional legislation that would require the automatic termination of Private Mortgage Insurance when specific conditions are met).
2. *See* CAL. CIV. CODE § 1695(a) (West 1985) (declaring legislative findings and intent regarding the Home Equity Sales Contracts Act); *see also* William N. Eskridge, Jr., *One Hundred Years of Ineptitude: The Need for Mortgage Rules Consonant with the Economic and Psychological Dynamics of the Home Sale and Loan Transaction*, 70 VA. L. REV. 1083, 1086-87 (1984) (noting the disadvantages faced by unsophisticated home buyers).
3. Eskridge, *supra* note 2, at 1086.
4. CAL. CIV. CODE §§ 1695-1695.17 (West 1985 & Supp. 1997).
5. *Id.* §§ 2945-2945.11 (West 1993 & Supp. 1997); *see* SENATE FLOOR, ANALYSIS OF AB 669, at 4 (June 17, 1997) (indicating that the purpose of the Home Equity Contracts Act is to protect innocent homeowners from predatory equity purchasers); *see also* SENATE FLOOR, ANALYSIS OF AB 1160, at 3 (June 19, 1997) (indicating that many borrowers do not understand their rights relating to cancellation of private mortgage insurance).
6. *See* CAL. INS. CODE § 119 (West 1993) (defining "mortgage guaranty insurance" as insurance against financial loss by reason of the nonpayment of sums agreed to be paid under the terms of the note); *see also id.* § 12640.02 (West 1988) (further defining mortgage guarantee insurance).

I. EXISTING LAW PRIOR TO THE ENACTMENT OF CHAPTER 50

A. The Home Equity Sales Contracts Act

The HESCA and the MFCA were enacted in 1979 to protect property owners[7] whose residences are in foreclosure[8] from unfair dealings with home equity purchasers[9] and mortgage foreclosure consultants.[10] Often, homeowners experiencing a period of financial distress will borrow against the equity[11] in their homes.[12] To secure the loan, the home equity purchaser will take title to the property.[13] The future intent of the parties is that the homeowner will repurchase the property.[14] To safeguard the interests of the homeowner, the HESCA allows a homeowner to cancel a home equity sales contract within five business days after the signing of the contract, or until eight o'clock in the morning on the day the property is to be sold, whichever comes first.[15] This "cooling off" period, within which the homeowner may cancel the contract, is triggered by the signing of the contract.[16] The Act requires that a home equity sales contract contain specific notices and disclosures

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7. *See id.* § 1695.1(f) (West 1985) (defining a "property owner" as "the record title owner of the property in foreclosure at the time the notice of default was recorded").

8. *See id.* § 1695.1(b) (West 1985 & Supp. 1997) (defining a "residence in foreclosure" as residential real property consisting of one to four-family dwelling units, one of which is owner occupied as a principal place of residence, against which an outstanding notice of default is recorded).

9. *See id.* § 1695.1(a) (West 1985 & Supp. 1997) (defining an "equity purchaser" as one who acquires title to any residence in foreclosure, and enumerating exceptions to this definition). *But see* Segura v. McBride, 5 Cal. App. 4th 1028, 1037, 7 Cal. Rptr. 2d 436, 441 (1992) (explaining that the Act regulates not only the predatory purchaser, but all equity purchasers, with the intent to protect the precious asset of home equity).

10. *See* CAL. CIV. CODE § 1695 (West 1985) (declaring legislative findings and intent regarding the HESCA); *see also id.* § 2945.1(a) (West Supp. 1997) (defining a "mortgage foreclosure consultant" as any person who makes solicitation to any owner to perform for compensation any of several enumerated services). *See generally Review of Selected 1979 California Legislation,* 11 PAC. L.J. 259, 584-92 (1980) (discussing the provisions of the HESCA at the time of its inception).

11. *See* BLACK'S LAW DICTIONARY 540 (6th ed. 1990) (defining "equity" as the difference between the fair market value and the debt in property).

12. *See* Julia Patterson Forrester, *Mortgaging the American Dream: A Critical Evaluation of the Federal Government's Promotion of Home Equity Financing,* 69 TUL. L. REV. 373, 388 (1994) (discussing the problem of predatory lending).

13. *See, e.g.,* Boquilon v. Beckwith, 49 Cal. App. 4th 1697, 1704, 57 Cal. Rptr. 2d 503, 507 (1996) (explaining that the home equity purchaser obtained a grant deed out of fear that the homeowner would not pay the loan).

14. *See id.* at 1704, 57 Cal. Rptr. 2d at 507 (illustrating a fact pattern in which title was transferred to the home equity purchaser via a grant deed for the purpose of refinancing the home with the understanding that title would be transferred back following the refinancing); *see also Segura,* 5 Cal. App. 4th at 1037-38, 7 Cal. Rptr. 2d at 441-42 (explaining the problems that occur when the homeowner claims a repurchase right to the house which was never reduced to writing).

15. CAL. CIV. CODE § 1695.4 (amended by Chapter 50).

16. SENATE RULES COMMITTEE, COMMITTEE ANALYSIS OF AB 669, at 2 (June 17, 1997).

regarding the homeowner's right to cancel.[17] Additionally, during this cooling off period, the equity purchaser may not: (1) accept an execution of, or induce the seller to execute, an instrument conveying any interest in the residence in foreclosure; (2) record any document with the county recorder; (3) transfer or encumber any interest in the residence being foreclosed to any third party; or (4) pay the equity seller any consideration.[18] Existing law also provides that a home equity purchaser who violates provision three, regarding transfer or encumbrance during the cooling off period, is subject to exemplary, treble damages.[19] Treble damages are also available if a home equity purchaser initiated a contract which takes unconscionable advantage of the property owner in foreclosure.[20]

B. The Mortgage Foreclosure Consultants Act

The MFCA was also designed to protect property owners whose homes are in foreclosure.[21] Mortgage foreclosure consultants claim that they can assist these homeowners, but often they perform no service while charging high fees which are secured via a deed of trust on the endangered residence.[22] Additionally, some homeowners, who rely on the representations of the consultants, do not investigate other options and lose their homes, often to the consultant who purchases the foreclosed property at a reduced price.[23]

The MFCA requires a mortgage foreclosure consultant to provide the homeowner with a written contract containing various disclosures and a notice of the homeowner's right of cancellation.[24] It also enumerates seven violations, the breach of which provide the homeowner a civil cause of action against the foreclosure consultant.[25] A court may, in its discretion, award exemplary damages for any violation

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17. *See* CAL. CIV. CODE § 1695.3 (amended by Chapter 50) (illustrating the proper form of the contract and specifying notice that must be included); *see also id.* § 1695.5 (amended by Chapter 50) (illustrating the proper form of the notice of right to cancel).

18. *See id.* § 1695.6(b) (amended by Chapter 50) (enumerating prohibited practices during the cooling period).

19. *Id.* § 1695.7 (West 1985 & Supp. 1997); *see id.* § 1695.8 (West Supp. 1997) (providing criminal penalties of fines and imprisonment for equity purchasers who engage in any practice operating as a fraud or deceit upon an equity seller).

20. *Id.* § 1695.7 (West 1985); *see id.* § 1695.13 (West 1985) (prohibiting any person from initiating any transaction involving residential real property in foreclosure who, by the terms of the transaction, takes unconscionable advantage of the property owner in foreclosure).

21. *See id.* § 2945 (West 1993) (stating the legislative intent of the Act).

22. *Id.*

23. *Id.*; *see* Onofrio v. Rice, 55 Cal. App. 4th 413, 417, 64 Cal. Rptr. 2d 74, 75-76 (1997) (detailing facts that the consultant diverted the plaintiff from genuine assistance, offered a loan at a 35% interest rate which was secured with a deed of trust, and bought the property after the plaintiff's default).

24. *See* CAL. CIV. CODE § 2945.3 (amended by Chapter 50) (requiring specific disclosures and notice of cancellation to appear on the contract).

25. *See id.* § 2945.4 (West 1993) (prohibiting the foreclosure consultant from doing the following: (a) claiming compensation prior to the full performance of all services; (b) charging any fee, interest, or compensation which exceeds 10% annually the amount of any loan made to the property owner; (c) taking a wage assignment or

of the act.[26] However, if the court determines that the foreclosure consultant has: (1) Claimed compensation prior to the performance of all services; (2) claimed a fee, interest, or compensation in excess of 10% annually of the amount of any loan made to the property owner; or (3) received consideration from a third party without disclosure to the homeowner, and the court chooses to award exemplary damages, then the court must award damages in an amount at least three times the compensation received by the consultant.[27]

Chapter 50 was enacted to strengthen the provisions of both HESCA and MFCA, as well as to decrease the possibility that HESCA will be misinterpreted.[28] The enactment attempts to eliminate the possibility that consultants may intentionally violate either act to avoid exposure to exemplary treble damages.[29] This possibility was brought to the attention of the legislature by the holding in *Boquilon v. Beckwith*,[30] which is expressly abrogated by Chapter 50.[31]

C. The Boquilon v. Beckwith *Anomaly*

In *Boquilon*, the court held that the plaintiff homeowners were not entitled to treble damages when the real estate agent acquired title to the property while the property was in foreclosure and the plaintiffs were not provided with a written contract.[32] The reasoning of the court was that the cooling off period never occurred

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lien to secure payment of compensation; (d) receiving consideration from a third party for services rendered the property owner without disclosure to the owner; (e) acquiring any interest in the residence; (f) taking power of attorney; or (g) inducing the owner to enter into a contract which does not comply with the Act).

26. *Id.* § 2945.6 (amended by Chapter 50).

27. *See id.* (stating that "the court may in its discretion award exemplary damages and shall award exemplary damages equivalent to at least three times the compensation received by the foreclosure consultant in violation of subdivision (a), (b), or (d)"). *Compare* SENATE RULES COMMITTEE, COMMITTEE ANALYSIS OF AB 669, at 3 (asserting that both prior law and AB 669 "allow" a court to assess exemplary damages if a violation of subsection (a), (b), or (d) is found, implying that the grant of an award is discretionary), *with Onofrio*, 55 Cal. App. 4th at 423, 64 Cal. Rptr. 2d at 80 (asserting that if the court finds the enumerated section 2945.5 violations, the court *must* award treble damages, implying that the grant of exemplary damages is mandatory if those violations are found).

28. SENATE FLOOR, ANALYSIS OF AB 669, at 1 (June 17, 1997) (declaring the intent to strengthen provisions of both acts to protect homeowners in foreclosure); *see* ASSEMBLY COMMITTEE ON JUDICIARY, COMMITTEE ANALYSIS OF AB 669, at 2 (May 13, 1997) (explaining the problem that had arisen in interpreting HESCA).

29. *See* SENATE FLOOR, ANALYSIS OF AB 669, at 3-4 (June 17, 1997) (stating the legislative intent to both abrogate the holding in *Boquilon* and also to eliminate the incentive to ignore either act in order to avoid treble damages).

30. 49 Cal. App. 4th 1697, 1715-18, 57 Cal. Rptr. 2d 503, 514 (1996).

31. *See* 1997 Cal. Legis. Serv. ch 50, sec. 6, at 281 (West) (abrogating the holding in *Boquilon*); *see also* SENATE JUDICIARY COMMITTEE, COMMITTEE ANALYSIS OF AB 669, at 3-7 (June 17, 1997) (detailing the *Boquilon* problem and the intended effect of Chapter 50).

32. *Boquilon*, 49 Cal. App. 4th at 1713-14, 57 Cal. Rptr. 2d at 513-14. *See generally* SENATE JUDICIARY COMMITTEE, COMMITTEE ANALYSIS OF AB 669, at 4 (June 17, 1997) (explaining the committee's interpretation of the holding in *Boquilon*).

because there was no written contract.[33] Therefore, the defendant could not have violated section 1695.6(b)(3) of the Civil Code, which forbids the transfer or encumbrance of property during the cooling off period.[34] Additionally, because there was no section 1695(b)(3) violation, there was no mandatory assessment of treble damages pursuant to section 1695.7 of the Civil Code.[35] However, the defendant was found guilty of a violation of both section 1695.6(a),[36] because she did not provide a contract commensurate with the act, and section 1695.6(e),[37] because she transferred an interest in the property to her husband and also because she encumbered the property (via refinancing) without the owner's consent.[38] Neither of these violations trigger the mandatory treble exemplary damages.[39] It is also important to note that the trial court did not find that the defendant's conduct was unconscionable, malicious, or deliberate.[40]

The dissent in *Boquilon* points out that this statutory interpretation creates a situation in which a sophisticated equity purchaser may avoid treble damages by failing to provide a contract, thus violating the fundamental requirement of the statute.[41] *Boquilon* also creates the anomalous situation in which a purchaser who provides a contract in compliance with her statutory duty, and then transfers the property prior to the termination of the cooling off period, may be punished more

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33. *See Boquilon*, 49 Cal. App. 4th at 1713-14 n.15, 57 Cal. Rptr. 2d at 513-14 n.15 (noting that without the written contract, there is no way to mark the beginning of the statutory cancellation period); *see also* SENATE FLOOR, ANALYSIS OF AB 669, at 4 (June, 17, 1997) (explaining that since there was no contract, there was no cooling off period and therefore, no transfer within the cooling off period).

34. *Boquilon*, 49 Cal. App. 4th at 1713, 57 Cal. Rptr. 2d at 513.

35. *See* CAL. CIV. CODE § 1695.7 (West 1985) (awarding mandatory treble damages for any violation of § 1695.6(b)(3) or § 1695.13); *see also Boquilon*, 49 Cal. App. 4th at 1714, 57 Cal. Rptr, at 514 (explaining that violations other than § 1695.6(b)(3) require the additional unconscionable advantage element of § 1695.13 in order to reach the level where mandatory treble damages will be awarded); *cf.* CAL. CIV. CODE § 1695.13 (West 1985 & Supp. 1997) (prohibiting transactions in which any person takes unconscionable advantage of the property owner).

36. *See* CAL. CIV. CODE § 1695.6(a) (amended by Chapter 50) (requiring the delivery of a contract conforming to the act).

37. *See id.* § 1695.6(e) (amended by Chapter 50) (prohibiting an equity purchaser from encumbering or transferring an interest in the property without written consent of the homeowner).

38. *Boquilon*, 49 Cal. App 4th at 1712, 57 Cal. Rptr. 2d at 512-13.

39. *See* CAL. CIV. CODE § 1695.7 (amended by Chapter 50) (stating that the court "shall award exemplary damages in an amount not less than three times the equity seller's actual damages" for any violation of §1695.6 (b)(3) or § 1695.13).

40. *Boquilon*, 49 Cal. App 4th at 1714 n.17, 57 Cal. Rptr. 2d at 514 n.17; *see infra* notes 59-63 and accompanying text (discussing the due process requirement to consider the reprehensibility of the defendant's conduct when assessing exemplary damages).

41. *See* CAL. CIV. CODE § 1695.6(a) (amended by Chapter 50) (compelling the equity purchaser to provide the homeowner with a contract conforming to HESCA requirements); *see also Boquilon*, 49 Cal. App. 4th at 1725, 57 Cal. Rptr. 2d at 521 (Kline, J., concurring and dissenting) (referring to the majority's interpretation as an entrance into the "realm of Alice in Wonderland").

severely than a culpable purchaser who transfers the property after deliberately failing to provide the contract.[42]

II. LEGISLATIVE REMEDIES

Chapter 50 seeks to remedy the problems brought to light in *Boquilon* by making specific changes to the Home Equity Contracts Act.[43] Additionally, it brings the Mortgage Foreclosure Consultant's Act into compliance with these changes and revamps its exemplary damages scheme.[44]

The first problem illustrated in *Boquilon* was that unscrupulous equity purchasers or mortgage foreclosure consultants could escape liability for treble damages by failing to provide a contract.[45] To remedy this, Chapter 50 allows the homeowner the right to cancel a home equity sales contract if an equity purchaser does not provide the homeowner with a contract complying with the act.[46] It also allows a homeowner to cancel a mortgage foreclosure service contract, if the foreclosure consultant does not provide the homeowner with a contract complying with the MFCA.[47] A contract is in compliance with either act if it is written, includes specific disclosures, and includes a notice of a right to cancel.[48]

These measures discourage the practice of failing to provide a written contract conforming to the Act.[49] They also expand the cancellation period to include both the period of time before a contract is signed, as well as the "cooling off period" which follows the signing of the contract.[50] This avoids the need to "trigger" the cancellation period.[51]

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42. *Boquilon*, 49 Cal. App. 4th at 1726, 57 Cal. Rptr. 2d at 522 (Kline, J., concurring and dissenting); *see* SENATE RULES COMMITTEE, COMMITTEE ANALYSIS OF AB 669, at 4 (June 17, 1997) (reiterating the arguments of the dissent as support for Chapter 50).

43. *See* SENATE RULES COMMITTEE, COMMITTEE ANALYSIS OF AB 669, at 1-3 (June 17, 1997) (detailing the changes made by Chapter 50 to both the HESCA and the Mortgage Foreclosure Consultant's Act).

44. *Id.* at 1-3.

45. SENATE RULES COMMITTEE, COMMITTEE ANALYSIS OF AB 669, at 4 (June 17, 1997).

46. CAL. CIV. CODE § 1695.5(d) (amended by Chapter 50).

47. *Id.* § 2945.3(g) (amended by Chapter 50).

48. *See id.* § 1695.3 (West 1985) (providing the required form of a home equity sales contract); *see also id.* § 1695.5 (amended by Chapter 50) (providing the proper form that the notice of cancellation, which is to be attached to the home equity sales contract, should take); *id.* § 2945.3 (amended by Chapter 50) (detailing the compliance requirements for a mortgage foreclosure consultant contract and providing the form of the notice of cancellation within the contract).

49. *See* ASSEMBLY COMMITTEE ON JUDICIARY, COMMITTEE ANALYSIS OF AB 669, at 2 (May 13, 1997) (stating a need to clarify the Act due to the perverse incentive created for an equity purchaser who may avoid treble damages by failing to provide the homeowner with notice of the homeowner's right to rescind).

50. *See* CAL. CIV. CODE §1695.6(b)(3) (amended by Chapter 50) (prohibiting transfer of an interest in the property until the time within which the equity seller may cancel the transaction has fully elapsed); *see also* SENATE RULES COMMITTEE, COMMITTEE ANALYSIS OF AB 669, at 3 (June 17, 1997) (stating that the bill allows a homeowner to cancel a foreclosure consultant services contract until the consultant has complied with the act).

51. SENATE COMMITTEE ANALYSIS, COMMITTEE ANALYSIS OF AB 669, at 2 (June 17, 1997).

A. Expansion of Exemplary Damages

This expansion of the cancellation period has the effect of allowing treble damages in home equity sales cases where no conforming contract has been delivered and the equity purchaser has transferred or encumbered the property.[52] Additionally, Chapter 50 expressly provides that a finding of a California Civil Code section 1695.6(e) violation (transfer of an interest in the property without the owner's consent) does not preclude the further finding of a California Civil Code section 1695.6(b)(3) violation (transfer of an interest within the cancellation period) and it does not preclude the assessment of treble damages because these violations are not mutually exclusive.[53]

While Chapter 50 broadens the exemplary damages available to plaintiffs under the HESCA by including pre-contract time within the ambit of the cooling off period, the enactment also makes specific changes broadening the exemplary damage scheme of the Mortgage Foreclosure Consultant Act.[54]

Under existing law, the court was permitted to assess, at its discretion,[55] exemplary damages of at least three times the compensation received[56] by the foreclosure consultant if the consultant perpetrated specific, prohibited acts.[57] Chapter 50 expands the potential for treble damage awards by allowing a discretionary assessment of at least three times the owner's actual damages if the consultant: (1) takes a wage assignment, lien on the property, or other security to secure the

52. *See* CAL. CIV. CODE § 1695.5(d) (amended by Chapter 50) (allowing the equity seller to cancel a contract any time prior to the time in which the equity seller has delivered a contract conforming to California Civil Code § 1695.4); *see also id.* § 1695.6(b)(3) (amended by Chapter 50) (making it a violation to transfer an interest within the cancellation period); *id.* § 1695.7 (West 1993 & Supp. 1997) (allowing assessment of treble exemplary damages for California Civil Code § 1695.6(b)(3) violations).

53. *See id.* § 1695.6(e) (amended by Chapter 50) (prohibiting an equity purchaser from transferring or encumbering property without the homeowners consent where the homeowner holds an option to repurchase the residence); *see also id.* § 1695.6(b)(3) (amended by Chapter 50) (prohibiting an equity purchaser from transferring or encumbering the property during the cancellation period); SENATE JUDICIARY COMMITTEE, COMMITTEE ANALYSIS OF AB 669, at 6 (June 17, 1997) (stating that the provision is necessary to further abrogate the holding in *Boquilon*, which stated that the two code sections cannot be applied at the same time).

54. *See* SENATE JUDICIARY COMMITTEE, COMMITTEE ANALYSIS OF AB 669, at 5 (discussing the goals of Chapter 50 as providing an indefinite cooling off period, as well as providing treble damages for specific violations of the Acts).

55. *See supra* note 27 and accompanying text (discussing alternative statutory interpretations regarding the extent of the court's discretion).

56. *See* CAL. CIV. CODE § 2945.6 (amended by Chapter 50) (stating that the exemplary damages are to be at least three times the compensation received by the foreclosure consultant in violation of subdivision (a), (b) or (e) of § 2945.4 of the California Civil Code).

57. *See id.* § 2945.6 (providing for the assessment of treble damages against a mortgage consultant who violates subdivisions (c), (e) or (g) of § 2945.4 of the California Civil Code); *see also id.* § 2945.4(a) (West 1993) (prohibiting the receipt or demand of compensation by the foreclosure consultant prior to full performance of every service that the consultant represented they would perform); *id.* § 2945.4(b) (West 1993) (prohibiting the receipt or demand of any interest, fee, or compensation which exceeds an annual interest rate of 10% on a loan made by the foreclosure consultant to the homeowner); *id.* § 2945.4(d) (West 1993) (prohibiting the receipt of consideration from a third party for services rendered to an owner without full disclosure to the homeowner).

payment of compensation; (2) acquires an interest in the residence in foreclosure; or (3) induces or attempts to induce any owner to enter into a contract which does not comply with the act.[58]

B. Exemplary Damages and Due Process Concerns

Even prior to the changes brought by Chapter 50 to the exemplary damages schemes, there was a potential that the provisions for damages within the Acts were vulnerable to attack on the basis that they may violate the Due Process Clause of the Constitution.[59] The Fourteenth Amendment prohibits states from taking an individual's life, liberty or property without due process of law.[60] An award of exemplary damages, often termed punitive damages, can implicate both procedural and substantive due process concerns.[61] Procedural due process is violated if a state uses an unfair procedure to take away life, liberty, or property.[62] Substantive due process concerns arise if a punitive damage award is so grossly excessive as to be arbitrary.[63]

In order to satisfy procedural due process, a State must provide meaningful standards to guide the application of its laws.[64] Fair procedures require proper jury instructions, post-verdict review by the trial court, and appellate review of the award.[65] If fair procedures are followed, a judgment is entitled to a strong presumption of validity.[66]

Several California courts have determined that section 14.17 of B.A.J.I., the standard punitive damage jury instruction, sufficiently imparts to the jury the nature and purpose of such an award, so as to comply with federal procedural due process

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58. *See id.* § 2945.6 (amended by Chapter 50) (providing for the assessment of damages at least equivalent to three times the homeowners actual damages for a violation of subsections (c), (e) or (g) of § 2945.4 of the California Civil Code); *see also* CAL. CIV. CODE § 2945.4(b) (West 1993) (prohibiting compensation exceeding a 10% annual interest rate on the loan); *id.* § 2945.4(c) (West 1993) (prohibiting compensation prior to completion of service); *id.* § 2945.4(g) (West 1993) (prohibiting attempts to induce the homeowner to enter a non-complying contract).

59. *Review of Selected 1979 California Legislation,* 11 PAC. L.J. 259, 592 (1980).

60. U.S. CONST. amend. XIV; CAL. CONST. art. I, § 7.

61. *See* Browning-Ferris Indus. v. Kelco Disposal, 492 U.S. 257, 274-75 (1989) (using the terms "punitive damages" and "exemplary damages" interchangeably); *see also* Christopher V. Carlyle, *Big Business Beware: Punitive Damages Do Not Violate the Fourteenth Amendment According to* Pacific Mutual Life Insurance Co. v. Haslip, 19 PEPP. L. REV. 1397, 1411 (1992) (discussing substantive and procedural due process in the context of punitive damage awards, in light of *Haslip*).

62. Carlyle, *supra* note 61, at 1411.

63. *Id.*

64. Pacific Mut. Life Ins. Co. v. Haslip, 499 U.S. 1, 45 (1991) (O'Connor, J., dissenting).

65. *Compare id.* at 23 (reviewing Alabama's jury instructions and system of appellate review and finding that it meets the fairness requirement of due process), *with* Honda Motor Co. v. Oberg, 512 U.S. 415, 432 (1994) (finding that Oregon's lack of appellate review of punitive damage awards violates due process requirements).

66. TXO Prod. Corp. v. Alliance Resources Corp., 509 U.S. 443, 456-57 (1993).

requirements.[67] In addition, California also requires meaningful judicial scrutiny of punitive damage awards at both the trial court and appellate levels.[68] Therefore, as a general matter, California procedure appears to comply with procedural due process requirements.

While it is permissible for a State to impose punitive damages to further its legitimate interests in punishing and deterring unlawful conduct, if an award is "grossly excessive" in relation to these interests, the arbitrary character of the award may violate substantive due process.[69] To determine whether a particular award is grossly excessive in relation to the state's interests, three factors must be considered: (1) The reprehensibility of the conduct; (2) the disparity between the harm suffered and the damages awarded; and (3) the difference between the remedy imposed and those remedies authorized or imposed in comparable cases.[70] The California Supreme Court has also provided factors that must be considered by a reviewing court to determine if an award is grossly disproportionate.[71]

Both the U.S. Supreme Court and the California Supreme Court agree that punitive damages must be fair in relation to the reprehensibility of the defendant's conduct to satisfy substantive due process.[72] The changes to the Home Equity Contracts Act initiated by Chapter 50 create the potential that an equity purchaser who transfers property with ignorance of the contractual requirements of the Act will be held to the same treble damages standard as a culpable equity purchaser who ignores the requirements of the Act altogether.[73] HESCA's exemplary damage

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67. *See* Las Palmas Assoc. v. Las Palmas Ctr. Assoc., 235 Cal. App. 3d 1220, 1257, 1 Cal. Rptr. 2d 301, 323 (1991) (finding that BAJI 14.71 offers the same protection as the instructions found constitutional in *Haslip*); *see also* Hilgedick v. Kowhring Fin. Corp., 8 Cal. Rptr. 2d 76, 89 (1992) (determining that B.A.J.I. 14.71 provides greater protection than the instructions in *Haslip*), *certified for partial publication*.

68. *See Honda Motor Co.*, 512 U.S. at 429 (noting that following *Haslip*, California courts have recognized the requirement of judicial review of punitive damage awards); *see also* Adams v. Murakami, 54 Cal. 3d 105, 118, 813 P.2d 1348, 1356, 284 Cal. Rptr. 318, 326 (1991) (recognizing the high court's constitutional mandate for meaningful judicial scrutiny of punitive damages); *Las Palmas Assoc.*, 235 Cal. App. 3d at 1258 n.8, 1 Cal. Rptr. at 324 n.8 (noting that on a motion for a new trial, the trial court sits as an independent trier of fact and may reweigh the evidence and draw reasonable inferences contrary to those drawn by the jury, that an appellate court has the responsibility to scrutinize punitive damage verdicts, and opining that on the whole, California law safeguards satisfy the requirements of due process). *See generally infra* notes 69-71 and accompanying text (explaining the substantive requirements a reviewing court must consider in order to comply with due process).

69. BMW of N. Am., Inc. v. Gore, 116 S. Ct. 1589, 1595 (1996).

70. *Id.* at 1598-99.

71. *See* Neal v. Farmers Ins. Exch., 21 Cal. 3d 910, 928, 582 P.2d 980, 990, 148 Cal. Rptr. 389, 399 (1978) (enumerating the following factors to be weighed: (1) the nature of the defendant's acts in light of the whole record; (2) the ratio of punitive damages to compensatory damages; and (3) whether the award exceeds the goals of punishment and deterrence in light of the defendant's wealth); *see also Adams*, 54 Cal. 3d at 110-13, 813 P.2d at 1350-53, 284 Cal. Rptr. at 321-23 (analyzing the *Neal* factors in light of *Haslip*).

72. *See BMW of N. Am., Inc.*, 116 S. Ct. at 1599 (noting that 150 years ago, the Court recognized that exemplary damages should reflect the enormity of the offense); *see also Neal*, 21 Cal. 3d at 928, 582 P.2d at 990, 148 Cal. Rptr. at 399 (stating that act of greater reprehensibility demand greater punishment).

73. *See* CAL. CIV. CODE § 1695.5(d) (amended by Chapter 50) (allowing a right of cancellation until the time in which the homeowner receives a contract in compliance with the Act); *see also id.* § 1695.6(b)(3) (West Supp. 1997) (creating a violation of the act if the property is transferred or encumbered during the cancellation period);

section allows the court the discretion not to assess exemplary damages.[74] The language of the Act distinguishes two situations in which treble damages may be considered: (1) If the equity purchaser takes unconscionable advantage of the homeowner; or (2) for a transfer of interest, either without a contract or during the cooling off period.[75] In the latter situation, no express provision has been made to require a culpable mental state. However, under California tort law, exemplary damages are only to be awarded if it is proven by clear and convincing evidence that the defendant is guilty of oppression, fraud, or malice.[76] Consideration of this standard during damage assessments diminishes the possibility that a punitive damage award would be grossly disproportionate to the reprehensibility of the ignorant equity purchaser's conduct. It is also interesting to note that the result in *Boquilon* might be the same under Chapter 50 if this standard were used to determine whether exemplary damages were appropriate. In *Boquilon*, the trial court expressly found no evidence of oppression or malice; thus the imposition of punitive damages might be disproportionate to the reprehensibility of the equity purchaser's acts.

Another substantive due process question may arise in the context of either the HESCA or MFCA once the decision to impose exemplary damages has been made by the court. Both statutes provide only a minimum level of damages assignable and the court is free to go above this suggested level.[77] However, no standards are provided within either section for determining when it would be appropriate to exceed the minimum guideline.[78] Since Chapter 50 mandates at least treble damages

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id. § 1695.7 (West 1985 & Supp. 1997) (giving the court discretion to assess treble damages for a transfer or encumbrance within the cancellation period); Boquilon v. Beckwith, 49 Cal. App. 4th 1697, 1714-15, 57 Cal. Rptr. 2d 503, 507 (1996) (considering the possibility that the prior legislative scheme may have been intended to protect innocent equity purchasers).

74. *See* CAL. CIV. CODE § 1695.7 (West 1985 & Supp. 1997) (granting the court discretion to award exemplary damages for Home Equity Sales Contract Act violations); *see also id.* § 2945.6(a) (amended by Chapter 50) (granting the court leave to award exemplary damages against Mortgage Foreclosure Consultants).

75. *See id.* § 1695.7 (West 1985) (awarding mandatory treble damages for any violation of § 1695.6(b)(3) or § 1695.13). *Cf. id.* §1695.13 (West 1985) (prohibiting transactions in which any person takes unconscionable advantage of the property owner); *id.* § 1695.6(b)(3) (amended by Chapter 50) (prohibiting transfer during the cancellation period); *id.* § 1695.5 (amended by Chapter 50) (extending the cancellation period to cover the period of time before a written contract complying with the act is provided to the homeowner).

76. *See id.* § 3294(a) (West 1997) (referring to the standards for allowing exemplary damages in "an action for the breach of an obligation not arising from contract"); *see also Las Palmas Assoc.*, 235 Cal. App. 3d at 1256 n.7, 1 Cal. Rptr. 2d. at 322 n.7 (noting that section 3294 of the California Civil Code codifies the common law regarding punitive damages).

77. *See* CAL. CIV. CODE § 1695.7(a) (West 1985 & Supp. 1997) (setting treble damages as the minimum level of exemplary damages the court may award for Home Equity Sales Contract Act violations); *see also id.* § 2945.6(a) (amended by Chapter 50) (setting treble damages as the minimum level of exemplary damages to be awarded against Mortgage Foreclosure Consultants).

78. *See* CAL. CIV. CODE § 1695.7 (West 1985 & Supp. 1997) (demanding at least treble damages, if any award of exemplary damages is given for Home Equity Sales Contract Act violations); *see also id.* § 2945.6(a) (amended by Chapter 50) (demanding at least treble damages be given if any award of exemplary damages is given against Mortgage Foreclosure Consultants).

if any damages are awarded, it is conceivable that an award may exceed the wealth of the defendant.[79] However, the fact that the initial imposition of exemplary damages is discretionary may provide the flexibility necessary to avoid this result.[80] Additionally, while the lack of discretionary guidelines may lead to a due process problem, California does have set procedures in place for appellate review of awards.

Overall, the changes wrought by Chapter 50 to the Home Equity Contracts Act and the MFCA provide great protection to homeowners who find themselves in the unfortunate situation of default on their mortgage.[81] The provisions ensuring the exchange of a written contract in compliance with the act will increase a homeowner's awareness of his rights under the law.[82] Though there may be a potential for due process violations in particular cases, it appears that California has a scheme of appellate review that would both discover any lower court errors relating to substantive due process issues and satisfy the procedural requirements of due process as well.[83]

III. PRIVATE MORTGAGE INSURANCE

While Chapter 50 protects against some of the perils that may befall homeowners whose homes are in foreclosure, Chapter 65 seeks to protect unsophisticated homeowners from overpaying their Private Mortgage Insurance (PMI).[84] Generally, lenders require PMI when a borrower does not have a twenty percent down payment.[85] The purpose of PMI is not to insure the borrower, but to protect the lender against financial loss in the event of the borrower's default.[86] PMI promotes

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79. *See id.* § 1695.7 (West 1985 & Supp. 1997) (demanding at least treble damages, if any award of exemplary damages is given for Home Equity Sales Contract Act violations); *see also id.* § 2945.6(a) (amended by Chapter 50) (demanding at least treble damages be given if any award of exemplary damages is given against Mortgage Foreclosure Consultants); *supra* note 71 and accompanying text (discussing the California standard requiring that an award not exceed the goals of punishment and deterrence in light of the defendant's wealth).

80. *See supra* note 74 and accompanying text (illustrating the judicial discretion involved in assessing exemplary damages).

81. ASSEMBLY COMMITTEE ON JUDICIARY, COMMITTEE ANALYSIS OF AB 669, at 2 (May, 13, 1997).

82. *See id.* (noting that before Chapter 50, in an effort to avoid punitive damage assessment, equity purchasers would purposely neglect to provide homeowners with notice of their right to rescind).

83. *See supra* notes 59-79 and accompanying text (discussing the federal guidelines for due process and the standard of review of punitive damage awards in California).

84. *See* SENATE RULES COMMITTEE, COMMITTEE ANALYSIS OF AB 1160, at 3 (June 19, 1997) (stating that many borrowers do not understand what private mortgage insurance is and are unaware that they may cancel the coverage if certain conditions are met).

85. *Id.*

86. *See* CAL. INS. CODE § 12640.02(a) (West 1988 & Supp. 1997) (defining "mortgage guaranty insurance"); *see also* 143 CONG. REC. H1557-02, 1559 (daily ed. Apr. 16, 1997) (statement of Congressman Hansen) (stating that PMI should not be confused with a homeowner's protection policy as it does not insure the borrower).

home ownership in that it allows homeowners to purchase homes with as little as three to 5% as a down payment.[87]

As the debt on the loan is paid down, the lender's risk decreases because there is more equity in the real estate.[88] Most mortgage servicer's guidelines allow cancellation when the loan to value ratio (LTV) of the property is at 80%.[89] However, often homeowners are not even aware that they may cancel their PMI.[90] Also, the cancellation procedures instituted by lenders may exact a high level of both time and frustration on the part of the homeowner.[91] It has been estimated that at least 250,000 homeowners nationwide are overpaying their PMI.[92]

Existing law provides that a homeowner may cancel their PMI when certain conditions are met.[93] Chapter 65 requires automatic cancellation of PMI by the insurance company when the following conditions are met: (1) the encumbered real property is an owner-occupied, one-to-four unit, residential property; (2) the loan amount owed is equal to or less than 75% of the sales price or appraised value; (3) the borrower is current on payments and no more than one of the borrower's scheduled monthly payments has been thirty days past due within the last twelve months; and (4) the loan was executed after January 1, 1998.[94] Additionally, state and federally administered mortgages are exempted from the operation of Chapter 65.[95]

The progressive nature of Chapter 65 is illustrated by the difficulty consumers face in other states when canceling their PMI.[96] In 1996, class actions were pending in four states against lenders, servicers or insurance companies.[97] Additionally,

87. 143 CONG. REC. H1557-02, 1562 (daily ed. Apr. 16, 1997) (floor statement of Rep. Roukema).

88. SENATE RULES COMMITTEE, COMMITTEE ANALYSIS OF AB 1160, at 3 (June 19, 1997).

89. John Dawson, *Defenses to Claims Asserting a "Duty" to Cancel Private Mortgage Insurance*, 396 PRAC. L. INST. CORP. HANDBOOK 711, 714 (1996). *See generally* 143 CONG. REC. H1557-02, 1559 (daily ed. Apr. 16, 1997) (statement of Rep. Hansen) (discussing cancellation guidelines).

90. *See* SENATE JUDICIARY COMMITTEE, COMMITTEE ANALYSIS OF AB 1160, at 3 (June 17, 1997) (commenting that most borrowers do not know what PMI is or that they are allowed to cancel it).

91. *See* 143 CONG. REC. H1557-02, 1560 (daily ed. Apr. 16, 1997) (statement of Rep. Hansen) (indicating that Congressman Hansen himself had to fight with his servicer for four years to cancel his PMI).

92. *See id.* (stating that of the 2.1 million home mortgages insured in 1996, one million required PMI and that at least 250,000 homeowners nationally are overpaying their PMI at an average monthly cost of $30 to $100).

93. *See* CAL. CIV. CODE § 2954.7(a) (West 1993) (allowing a borrower to cancel PMI if: (1) the request to cancel is in writing; (2) the origination date of the note is at least two years prior to the request for cancellation; (3) the encumbered property is an owner-occupied, one to four unit residential real property; (4) the unpaid balance on the note is less than 75% of either the original sale price of the property or the appraisal value of the property, and (5) the borrower's payments have not been more than 30 days past due of the 24 month period immediately preceding the request, and no notice of default has been recorded pursuant to § 2924 of the California Civil Code).

94. *Id.* § 2954.12(a) (enacted by Chapter 65).

95. *See id.* § 2954.12(b)(2) (enacted by Chapter 65) (exempting loans funded pursuant to authority granted by statute that prohibits termination of PMI payments during the term of indebtedness).

96. *See* Dawson, *supra* note 89, at 718-21 (enumerating unsuccessful legal theories advanced in several jurisdictions in an attempt to force lenders to either make disclosures or cancel PMI).

97. *See id.* at 716 (noting that class actions were pending in Alabama, Texas, Minnesota, and New Jersey against the various companies).

plaintiffs often have difficulty finding a legal theory to support their claim that their PMI payments should be canceled.[98]

PMI plays a valuable role in expanding home ownership by enabling buyers to purchase homes with small down payments.[99] Additionally, PMI helps reduce the economic impact of downturns in the housing market by providing security for high risk loans through insuring lenders against defaulting borrowers.[100] Chapter 65 strikes a delicate balance between these interests. By maintaining the LTV ratio at 75%, lenders maintain security against default and consumers are protected, through the automatic cancellation provision, against paying needless premiums when their risk drops to acceptable levels.[101]

IV. CONCLUSION

The purpose of both Chapter 50 and Chapter 65 is to protect the interests of unsophisticated homeowners.[102] Chapter 65 effectuates this intent by eliminating the frustration involved in obtaining cancellation of PMI by requiring automatic cancellation.[103] At the same time, it protects lenders by requiring a loan to value ratio less than 75% before cancellation.[104] Chapter 50, in expressly abrogating the holding of *Boquilon*, protects homeowners from both culpable and ignorant equity purchasers and foreclosure consultants.[105] However, care must be taken so that this protection does not come at the price of the due process rights of innocent but ignorant equity purchasers.[106]

98. *See id.* at 717-22 (listing various causes of action that have been advanced to remedy the inequity of allowing consumers to continue paying for PMI when they receive no direct benefit, and the lenders receive little benefit).

99. 143 CONG. REC. H1557-02, 1562 (daily ed. Apr. 16, 1997) (statement of Congresswoman Roukema).

100. Representative James Hansen, *The Truth Behind Private Mortgage Insurance* (visited July 30, 1997) <http://www.house.gov/hansen/overvw.htm>.

101. *See* ASSEMBLY FLOOR, ANALYSIS OF AB 1160, at 2 (May 2, 1997) (commenting that the lender's risk decreases significantly once the LTV ratio is at 80%); *see also* 143 CONG. REC. H1557-02, 1562 (daily ed. Apr. 16, 1997) (statement of Rep. Roukema) (discussing the importance of balancing competing interests in federal legislation requiring automatic cancellation of PMI).

102. *See supra* notes 4-5 and accompanying text (discussing the goals of Chapters 50 and 65).

103. *See supra* notes 93-97 and accompanying text (illustrating the legislative intent of Chapter 65 as well as the frustration some borrowers face in obtaining cancellation).

104. *See supra* note 101 and accompanying text (exploring the benefits of a 75% LTV ratio as a prerequisite to PMI cancellation).

105. *See supra* notes 45-58 and accompanying text (explaining how the changes to HESCA and MFCA protect homeowners by encouraging compliance with the contract provisions of the Acts and by expanding the treble damage provisions of each Act).

106. *See* discussion *supra* Part II.B (discussing potential due process concerns related to the exemplary damage provisions of both the HESCA and the MFCA).