

MORTGAGE FRAUD

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This paper deals with what has commonly been called Mortgage Fraud. It does not deal with all potential types of fraud involving a mortgage company but only a very limited type. Specifically, it will discuss a situation where a home improvement contractor does work to a home and takes a mortgage on the home as payment for the work. As soon as the homeowner signs the mortgage, the contractor assigns the mortgage to a mortgage company. The mortgage company pays the contractor for the work done on the home by purchasing the mortgage. The mortgage company then collects the payments from the homeowner on the mortgage.

I am aware of several mortgage companies in the state of Alabama that take assignments from contractors in this way. They are Fleet Finance, Chrysler First Financial Services, Inc., Union Mortgage, Goldome, Greentree Acceptance, and First Family Financial Services, Inc. The purpose of this paper is to help lawyers recognize a potential cause of action that has often gone unnoticed. When a client comes to your office claiming that his house is going to be foreclosed on by a mortgage company, don't overlook the fact that there may have been some type of fraud perpetrated on him. Don't think that the only cause of action might be against the contractor who often has little money or

assets and may even be in bankruptcy. In many cases, the mortgage company may be responsible for some type wrongdoing.

The cases I have seen involve a fraudulent act by the home improvement contractor which is attributable to the mortgage company due to the close connection between the two. The fraudulent acts range from not doing any work on the home and leaving the homeowner owing on a mortgage to charging very high prices for very little work. In every case, the homeowner has been shortchanged and cheated in some manner.

In many situations, the mortgage company controls the acts of the home improvement contractor. The mortgage company gives the home improvement contractor all the necessary forms for the contractor to enter into a mortgage with the homeowner including the mortgage, Retail Installment Contract, and Truth in Lending documents. In most cases the documents have a place on the back where an assignment to the mortgage company is required. The mortgage company gives the contractor a credit application for the homeowner to sign. The credit applications in many cases will also have the mortgage company's name on it showing the mortgage company is in fact extending the credit. The mortgage company provides all other documentation for the mortgage between the contractor and the homeowner, i.e., Notice of Right to Cancel, Completion Certificate, employment verification forms, homeowners insurance forms, and all other documentation.

The home improvement contractor takes all of the above paperwork to the homeowner to sign. The contractor then sends all the paperwork back to the mortgage company. The mortgage company then gives the home improvement contractor a commitment letter stating that if the contractor does the work on the homeowner's home and enters into the mortgage with the homeowner, the mortgage company will purchase the mortgage between the homeowner and contractor at a certain price and a certain rate. They will only purchase the mortgage if it is based on the terms they quote.

As can be seen from the above, the mortgage company is really the one who is calling the shots. In most cases, the contractor will not do any work on the home unless he has a pre-approved financing arrangement. The contractor generally has no assets, no money to lend, and is really just like a division of the mortgage company.

The underlying mortgage between the contractor and the homeowner is really a sham. Obviously, a mortgage signifies a loan. There is no loan between the contractor and the homeowner.

No money changes hands. There is no loan until the mortgage company gets involved. Yet the deal is made to look as if the mortgage company is simply buying a loan from the contractor on the secondary market. This is done to insulate the mortgage company from liability involving the acts of the contractor. How do you hold the mortgage company responsible for the acts of the

contractor?

LEGAL THEORY

Depending on the facts, the legal theory is usually that the contractor defrauded the homeowner by promising to do good quality work and in fact doing bad quality work or defrauded the homeowner by telling the homeowner the price would be one thing and then charging them more, or by not doing any of the work and stealing the money. The mortgage company would be liable for the fraud of the contractor if the contractor can be shown to be the agent of

the mortgage company.

The ultimate issue in determining agency is whether the mortgage company reserved the right to control the contractor. In numerous situations, there is ample circumstantial evidence of such control to make the issue a jury question.

All of the underlying mortgage documents are usually provided to the contractor by the mortgage company. The credit application that the contractor gets the homeowner to sign has the mortgage company's name on it. The contractor will not do the work unless the mortgage company has already agreed to purchase the mortgage in advance. The mortgage company pays to have the title checked and to record the underlying mortgage. The mortgage company investigates the homeowner's credit. Since the mortgage company is actually making a loan to the homeowner, the contractor is the agent who does all of the preliminary work and who gets the signature on the mortgage company's documents.

It is most helpful to use an expert witness in this situation. An expert in banking can testify as to the status of the mortgage company. If the mortgage company is considered a primary lender, i.e., the initial lender or one who extends credit, then the company is actually making a direct loan to the homeowner. If the mortgage company is making a direct loan to the homeowner, the contractor must be the agent of the mortgage company since he is the only one who has contact with the

homeowner and is the person who secures the necessary signatures for the mortgage company. Again, this shows that the underlying mortgage between the homeowner and the contractor is in reality a sham.

Another theory is negligence or wantonness. Many of the companies have in their corporate records documents showing they are required to investigate the contractor on a periodic basis. Many representatives of mortgage companies will admit in deposition that they do as a matter of course investigate their dealers. Accordingly, the theory is that a mortgage company assumed a duty to investigate their contractors. If the company had investigated the contractor, they should have not done business with him and the Plaintiff would not have been injured. If the conduct is bad enough, wantonness could also go to the jury.

Another possible negligence or wantonness fact situation involves a stated or assumed duty to inspect during the construction itself. Some lenders charge the homeowner a fee for this "service".

DEFENSES

The most common defense is that the contractor is an independent contractor of the mortgage company. This can be very difficult to avoid. There is a new jury charge in the Alabama

Pattern Jury Instructions dealing with this.

That charge specifically states:

The Defendant contends that the Plaintiff should not recover against it because the contractor was not his servant, agent or employee at the time and place complained of but was an independent contractor.

It therefore becomes your duty to determine from the evidence whether at the time the Plaintiff received the injuries complained of, the contractor was acting as a servant or agent of Defendant or whether the contractor was an independent contractor.

An independent contractor is one who has contracted to do or perform work for another and reserves the exclusive right of control over the means and agencies and all of the details by which the work is to be done.

It is the reserve right of control rather than the actual exercise of control that furnishes the test of whether one is an independent contractor.

As can be seen from the above, it is the reserved right of control that is of the utmost importance in proving that the contractor was acting as an agent or servant for the mortgage company. It can be argued that the mortgage company reserves the right to control the acts of the contractor by telling the contractor he will not finance the deal unless the contractor does the work and fills out the forms exactly as the mortgage company dictates. In most cases there is circumstantial evidence regarding document preparation as we have discussed above.

The mortgage company will then take the position that since

the contractor is an independent contractor, they are simply buying mortgages on a secondary market. Since they are buying mortgages on a secondary market, they are not responsible for any acts that took place in the securing of the underlying mortgage. This is why an expert's testimony is so important regarding the lender's status as a primary lender.

When one uses all of these elements of circumstantial evidence of control and combines it with the testimony of an expert witness regarding status of the mortgage company as a primary lender, agency in most cases will be a jury question. Of course, every case stands on its own facts and a prudent practitioner should conduct full discovery until some element of right to control is found.

CASE LAW

There have been only two cases in Alabama that specifically deal with this type of mortgage fraud. Witherspoon v. Goldome Credit Corp., 544 So.2d 946 (Ala. 1989); Union Mortgage Co., Inc. v. Barlow, Ms. 1901350, Supreme Court of Alabama, Jan. 10, 1992 _____, So.2d _____ (Ala. 1992).

In Witherspoon, the Plaintiff contracted with Master Builder Construction Company to do home improvement work on his home. In exchange for Master Builder's work, Witherspoon gave Master Builder a promissory note and mortgage. Master Builder later

assigned the note and mortgage to Goldome. Goldome collected the payments.

Plaintiff alleged that Goldome was liable for the fraudulent acts of Master Builder. The Circuit Court of Montgomery County granted Summary Judgment for Goldome. The Supreme Court affirmed stating that evidence of the relationship between Master Builder and Goldome is insufficient to get by Summary Judgment.

The Court specifically held that the test in determining agency is reserved right to control the manner of the agent's performance.

This case can be difficult to get around from a Plaintiff's point of view. It must be noted that this is a Summary Judgment case with the homeowner being a defendant and counterclaim plaintiff. The facts were not allowed to be developed at trial. No expert testimony was used and the record before the court was very weak. Also, it is not evident whether the mortgage company handled the employment verification of the homeowner in the underlying mortgage or whether the mortgage company paid to have the underlying debt recorded or whether the mortgage company conducted the title search and credit check for the underlying mortgage. This type evidence would be a strong indication of the agency relationship.

In Union Mortgage v. Barlow, the Supreme Court affirmed a 6 million dollar verdict based on facts similar to the Witherspoon

case. While Barlow did not specifically overrule Goldome, it certainly allowed a cause of action where Goldome would not. Barlow deals with two distinct areas of fraud. It deals with a direct fraud by Union Mortgage Company in failing to disclose a discount rate. It also involves the fraud of Union Mortgage's contractor/agent who did work on Plaintiff's home. Since the direct fraud is so rarely found, this paper will not discuss it.

In Barlow, the home improvement contractor agreed to perform work for customers only if Union Mortgage agreed in advance to lend homeowner money for the repairs. Union Mortgage actually approved the loans and took immediate assignment of the mortgage.

It was contended that home repairs were of substantially less value than the amount charged by the contractor and the amount of the loan. Union Mortgage approved about 50% of the home mortgages that the contractor submitted. The contractor assigned the loan to Union Mortgage in the same paper document that the homeowner signed.

Plaintiff's expert testified that Union Mortgage could be considered a primary lender since it makes the credit decision. He also stated that the contractor would be considered the agent of Union Mortgage. The Court upheld the jury verdict thereby implying that the mortgage company can be responsible for the act of a contractor in these situations. This is the key case in Alabama and should definitely be cited as authority in these

situations.

One other case dealing with the issue of whether a person who defrauds Plaintiff is the agent of a finance company is Turner v. Deutz-Allis Credit Corp., 544 S.2d 840 (Ala. 1989). In Turner, the Trial Court granted Summary Judgment on Plaintiff's allegation that he was defrauded by the finance company's agent. The Supreme Court reversed and remanded.

Plaintiff contracted to buy a piece of farm equipment. The farm equipment was owned by another farmer who owed Deutz-Allis Credit Corporation on the tractor. Meadows Equipment Company was to transfer the tractor from the farmer to Turner with Turner assuming the payments to Deutz-Allis Credit Corporation. During the transaction, Turner claimed he was defrauded by Meadows while acting as the agent for the finance company in the transfer.

It was alleged that Meadows defrauded Turner by lying to him about the terms of finance agreement in order to get his signature on the transfer agreement. The Supreme Court stated that it was a jury question for whose benefit Meadows was acting at the time he negotiated the transfer of the tractor. Therefore, the case was reversed and remanded and fraud was allowed to go to the jury. This case resulted in a \$1,609,000 jury verdict.

This case can be used as authority in a mortgage fraud case. When the contractor goes to a homeowner to get the homeowner's signature on the mortgage company's documents, the question of

control becomes a jury question.

Other cases dealing with whether a person is an agent of a finance company are Potomac Leasing Co. v. Bulger, 531 So.2d 307 (Ala. 1988); Butler v. Aetna Finance Co., 587 So.2d 308 (Ala. 1991); Kimbrel v. Mercedes Benz Credit Corp., 476 So.2d 94 (Ala. 1985).

PRACTICE POINTERS

It is always helpful in these type cases to locate pattern and practice witnesses. This is necessary in order to get around the \$250,000 limitation on punitive damages. An excellent way to find pattern and practice witnesses is to go to the County Courthouse and look up the mortgages in the mortgage company's name. The homeowner's name, address and possibly telephone number will be listed on the mortgage. You can then contact these people to be witnesses for you if they have experienced similar problems.

Use an expert witness to testify regarding the status of the mortgage company as a primary lender. This is crucial to your agency connection. If the fraud that is alleged is that work was significantly over-valued, i.e., the contractor charged \$10,000 when the work was only worth \$2,000, you also need an expert contractor to testify that the value of the work was \$2,000. Most legitimate contractors will be eager to assist you in this type

case.

Check the court records to see if there have ever been any judgments against the contractor. Many of these contractors will have judgments against them where they didn't pay creditors and the like. This will help your negligence and wantonness argument if the company assumed the duty to investigate them. It will also help put some "fire" in your case and will enhance your damages.

Find an ex-employee of the mortgage company. This is helpful in any type fraud case. I usually ask the names, addresses and telephone numbers of anyone who was employed with the company at the time of the fraud that is no longer there. If they were fired, or had a bad work experience, they may have an ax to grind with the company and want to help you.

Check the banking department for complaints against the mortgage company. This resource can be very helpful. The banking department keeps complaints against mortgage companies for a certain amount of time.

Check the contractor's licensing board to see if the contractor has an updated license. Many mortgage companies require the contractor to have a license. If you catch one without a license, it will show they violated their own policies and can help with your negligence or wantonness theory.

Get a copy of the mortgage company's Policy and Procedures Manual. This will help you understand the exact manner in which

they deal and may provide help on the agency question.

Check the Attorney General's office to see if there has ever been any investigation of the contractor or the mortgage company.

Check the Better Business Bureau to see if there have ever been any complaints regarding the contractor or the mortgage company.

If you find pattern and practice witnesses from different counties, have a map blown up and highlight the area where each person is from. This will help show the jury that there is a wide-spread scheme to defraud.

Draw a chart showing the relationship between the parent company and the subsidiary companies of the mortgage company. In many cases, there are several subsidiary companies with one large company at the top. This helps show the jury the size of the company and the way in which they operate their business.

CONCLUSION

As stated in this paper, Mortgage Fraud cases have often gone unnoticed. In the future, consider a cause of action against the mortgage company based on the acts of its contractor if the facts warrant such.