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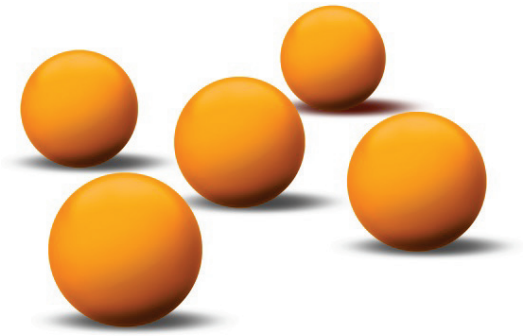

Wrongful Foreclosure: Acting Offensively May Short-Circuit the Need for a Defense

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In recent years, lenders have been forced to defend a record number of so-called "wrongful foreclosure" lawsuits. However, several Tennessee court rulings issued this year indicate that if lenders act quickly and offensively, they may prevent these challenges.

Typically, the story goes something like this: Borrowers fall behind on their payments, and the lender notifies them that they may qualify for a loan modification—either through the lender's own program or through a government-sponsored program like the Home Affordable Modification Program. So, borrowers send in a portion of the required documentation and make a couple of the trial payments. But, the modification is denied based either on failure to submit a completed modification packet or failure to make all of the trial payments, and the lender forecloses.

Then, the borrowers may move out voluntarily after the foreclosure. If they refuse to move out, the purchaser at the foreclosure sale or its agent must ask the courts to evict the borrowers by filing what's called an "unlawful detainer action." Later, the borrowers then file a "wrongful foreclosure" lawsuit against the lender, the servicer, the investor, the substitute trustee—and anyone else they can identify. Typically, the borrowers seek rescission of the foreclosure, damages for not approving a loan modification, and maybe even stripping the mortgage lien itself.

Only a handful of Tennessee cases discuss the remedies available to borrowers for allegations of "wrongful foreclosure." Most of these cases address "wrongful foreclosure" as a defense available to borrowers when the purchaser at the foreclosure sale seeks to evict them.[1] Other cases that mention recovery for "wrongful foreclosure" reveal the term "wrongful foreclosure" may be more of a description than an actual independent claim.[2] For example, Tennessee courts address recovery for "wrongful foreclosure" in the context of breaches of contract,[3] negligence and other torts,[4] and alleged statutory causes of action.[5]

Regardless, according to the Tennessee Court of Appeals, there is "absolutely no doubt" that allegations of "wrongful foreclosure" can be raised as a defense by the borrowers in the eviction proceeding.[6] This stems from the fact that the rights of a purchaser at foreclosure to evict the borrowers is dependent upon the passage of good title at foreclosure, and allegations of "wrongful foreclosure" will prevent an award of possession to the purchaser.[7]

This year, three Tennessee decisions were issued which clarify that once a final judgment is entered in an unlawful detainer action where a purchaser at foreclosure seeks to evict the borrowers, and the

appeals period has expired, subsequent claims of "wrongful foreclosure" are prohibited as a matter of law. This rule is based on the doctrine of *res judicata*—which in essence bars a second suit between the same parties or certain legally related parties on the same cause of action[8] with respect to all issues which were or could have been litigated in the former suit.[9] This doctrine applies equally to judgments of the General Sessions courts as to those of the Circuit and Chancery courts.[10] The Tennessee Court of Appeals issued two of these decisions—*Foster v Fannie Mae*[11] and *CitiMortgage, Inc., v Drake*[12]—and the US District Court for the Middle District of Tennessee issued the third—*Lawlor v SunTrust Mortgage, Inc*.[13]

All three of these recent decisions are based on the 2011 case of *Davis v Williams*[14] where the Tennessee Court of Appeals held that when right of possession stems from the acquisition of property at a foreclosure sale, then entry of final judgment in an unlawful detainer action bars a later, separate lawsuit over the validity of the foreclosure. The court reasoned that because there was "absolutely no doubt that wrongful foreclosure can be raised as an affirmative defense to an unlawful detainer action," the failure to raise this defense in response to an unlawful detainer action, and entry of a final judgment in that action, means that wrongful foreclosure is "conclusively determined not to exist."[15]

Although borrowers often attempt to distinguish their case based on allegations that the General Sessions court did not have jurisdiction to determine title, this is simply a red herring. In *Davis*, the court stated, "The Buyers maintain that even though the general sessions court could have denied the Sellers possession based on the defense of wrongful possession, its inability to set aside the foreclosure and vest title in them rather than the Sellers means that its judgment does not have preclusive effect. We disagree with the Buyers."[16]

Accordingly, when the right to possession depends upon the validity of the foreclosure sale, the borrower ***must*** raise the defense in response to the unlawful detainer action. If this is not raised, or if the challenge is raised and denied, then issues related to the validity of title are precluded in a subsequent suit once the time for an appeal has run. Similarly, a default judgment against borrowers in the eviction proceeding will bar a subsequent suit for "wrongful foreclosure," even though the borrowers did not raise that defense or even appear.[17]

Pragmatically, these cases have significant impact on lenders, especially if the lender is the purchaser at foreclosure through a credit bid, or if it is the servicer on behalf of a government entity such as Fannie Mae who becomes the purchaser.[18] These cases clarify that lenders and subsequent assignees may be able to avoid later claims of "wrongful foreclosure" from former borrowers by proceeding expeditiously to evict the borrowers through unlawful detainer proceedings. Ultimately, detainer actions let the lender gain control of the property for subsequent sale and may also force the borrower's hand regarding these allegations or prevent challenges to the foreclosure altogether.

Endnotes

1 *See, e.g., Davis v. Williams*, 2011 Tenn. App. LEXIS 35 (Tenn. Ct. App. Jan. 31, 2011); *Federal National Mortgage Association v. Robilio*, 2008 Tenn. App. LEXIS 359 (Tenn. Ct. App. June 28, 2008); *Citifinancial Mortgage Co., Inc. v. Beasley*, 2007 Tenn. App. LEXIS 20 (Tenn. Ct. App. Jan. 11, 2007).

2 The authors would argue that phrases such as "This is a tort action for wrongful foreclosure," *Miltier v. Bank of America, N.A.*, 2011 Tenn. App. LEXIS 152, at *2 (Tenn. Ct. App. Mar. 30, 2011), do not create a cause of action under Tennessee law, but merely describe the nature of the underlying lawsuit. This is similar to the assertions that "This is a tort action for personal injuries" in a case where a defendant is sued for personal injury on a theory of negligence or under the Workers' Compensation Law. *See, e.g., Campbell v. Dick Broadcasting*, 883 S.W.2d 604, 605 (Tenn. 1944); *Balsinger v. Gass*, 214 Tenn. 343, 345 (Tenn. 1964); *Wesco Paving Co. v. Nash*, 35 Tenn. App. 409, 411 (Tenn. Ct. App. 1951).

3 *See, e.g., Jerles v. Phillips*, 2006 Tenn. App. LEXIS 558 (Tenn. Ct. App. July 12, 2006); *Fed. Land Bank of Louisville v. Cloar*, 1989 Tenn. App. LEXIS 843 (Tenn. Ct. App. Dec. 28, 1989); *Whitsey v. Williamson County Bank*, 700 S.W.2d 562 (Tenn. Ct. App. 1985).

4 *See, e.g., Beal Bank, SSB v. Prince*, 2013 Tenn. App. LEXIS 63 (Tenn. Ct. App. Jan. 31, 2013).

5 *See, e.g., Held v. Tenn. Title Co.,* 448 S.W.2d 413 (Tenn. 1969); *Clay v. First Horizon Home Loan Corp*., 2012 Tenn. App. LEXIS 417 (Tenn. Ct. App. June 26, 2012).

6 *Davis*, 2011 Tenn. App. LEXIS 35, at *9.

7 *Robilio*, 2008 Tenn. App. LEXIS 359.

8 The Tennessee Supreme Court has held that "[t]wo suits . . . shall be deemed the same 'cause of action' for purposes of r*es judicata* where they arise out of the same transaction or a series of connected transactions." *Creech v. Addington*, 281 S.W.3d 363, 381 (Tenn. 2009).

9 *See A.L. Kornman Co. v. Metro. Gov't of Nashville*, 391 S.W.2d 633 (Tenn. 1965); *New York Life Ins. Co v. Nashville Trust Co*., 292 S.W.2d 749 (Tenn. 1956); *Scales v. Scales*, 564 S.W.2d 667 (Tenn. Ct. App. 1978); *Towe v. Brock*, 1996 Tenn. App. LEXIS 431, at *8 (Tenn. Ct. App. July 26, 1996).

10 *See Clay v. Barrington Motor Sales, Inc.* 832 S.W. 2d 33 (Tenn. Ct. App. 1992); *Towe*, 1996 Tenn. App. LEXIS 431, at *8.

11 *Foster v. Fannie Mae*, 2013 Tenn. App. LEXIS 492 (Tenn. Ct. App. July 21, 2013).

12 *CitiMortgage, Inc. v. Drake*, 2013 Tenn. App. LEXIS 116 (Tenn. Ct. App. Feb. 21, 2013).

13 *Lawlor v. SunTrust Mortgage, Inc.*, 2013 U.S. Dist. LEXIS 116584 (M.D. Tenn. Aug. 15, 2013).

14 *Davis*, 2011 Tenn. App. LEXIS 35.

15 *Id*. at *9-10.

16 *Id*. at *6.

17 *Mitrano v. Houser*, 240 S.W.3d 854, 861 (Tenn. Ct. App. 2007).

18 *Davis*, 2011 Tenn. App. LEXIS 35, at * 9-10.

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