Demystifying “May,” “Might” and “Could” In the Short Sale Fog – Part 1: “The Law” and “Fraud”
San Francisco is known for fog.
Los Angeles was known for smog.
I’m here to clear the air for all of California investor-based short sales.
Who is Ron Ballard?

- Graduate UCLA Law School 1983
- Admitted to California Bar 1983
- Went solo in 1985, initially serving real estate developers, www.ballardlaw.com
- Served as local land use attorney for a multi-billion dollar financial institution
- Represented California’s largest charitable/religious organization
- Emphasizes real estate, business and estate/asset protection planning
- Founder of the Real Estate Strategies Institute www.theresi.com
- Popular blog at www.CaliforniaShortSaleLawyer.com
Typical Attorney Stuff.....

Disclaimer: THIS presentation is educational.

Presenter is not giving individual legal, accounting, tax or other professional advice. Each individual circumstances must be carefully reviewed (and a retainer agreement signed and a fee paid) in order to receive legal advice. This also applies to any subsequent forum posts or Q & A sessions.
The next 60 minutes will be filled with non-stop, high-powered content.

Your chance to absorb it all will be like trying to drink from a fire hose. (Metaphor credit: Jeff Watson.)

Unfortunately, there might not be enough time for questions; however, I’ll be here for most of the weekend and there might be more legal Q&A sessions.

So “come on everybody, here we goooooo . . . ”

Quote source: Disneyland, Anaheim, CA. Peter Pan ride.
There are elephants in the room:

- Is it legal to flip short sale properties?
- When “may,” “might” or “could” some kind of short sale flips be illegal?
- Who could be looking at jail time or the federal “pen”?
Recent, official-sounding, articles, bulletins and web sites have created fear from lack of knowledge.

- Look at the context: authoritative or opinion.
- Look at the verbiage: “may,” “might” and “could”
- Look at the author: identified or not disclosed.
- Look at the agenda: other-serving or self-serving
“Show me it’s legal”

- This demand comes from the wrong direction.

- Our market system presumes that business transactions are legal UNLESS there is some basis for them to be illegal.

- Therefore, one usually can’t “show” someone that a transaction is legal.

- The burden is on the person contesting the transaction to show that it, or part of it, is illegal.
Let’s start with the Constitution

- From The Bill of Rights –

- The Ninth Amendment:
  - The enumeration in the Constitution, of certain rights, shall not be construed to deny or disparage others retained by the people.

- The Tenth Amendment:
  - The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.


The U. S. Department of State says:

◦ “The United States remains a ‘market economy.’ Americans continue to believe that an economy generally operates best when decisions about what to produce and what prices to charge for goods are made through the give-and-take of millions of independent buyers and sellers, not by government or by powerful private interests.”

◦ “Besides believing that free markets promote economic efficiency, Americans see them as a way of promoting their political values as well -- especially, their commitment to individual freedom and political pluralism and their opposition to undue concentrations of power.”

Historical Development of Law

- Common Law – court based, judicial law.
- Statutory Law – from legislative branch.
- Regulations – from executive branch.
- “Public benefits” – program requirements.
Understanding Common Law

- Began developing in England almost 1,000 years ago.
- Was embraced by independent American states (and U. S. Supreme Court) after the American Revolution.
- Is created by judicial decision, especially in laws of property, contracts and torts.
- Found in case law “precedents,” based on jurisdiction and lines of authority (Supreme Court is highest).
- Statutory laws will take precedence over conflicting common law. (However, a court can rule that a statute conflicts with higher law, such as the Constitution.)

Sources:
Statutes, Codes & Ordinances

- Are from legislative bodies and usually define **prohibitions** rather than **permissions**.

- Statutes are the original form of laws when they are enacted, after they started as a “bill”

- Codes are the organized system of finding statutes in “code books” often organized in titles, articles, divisions and sections (§ -- the “section sign”)

- “Ordinance” is the term often used for laws adopted by county supervisors and city councils. May be organized in a “municipal code” or county code.
Federal Regulations

- Are drafted by executive branch agencies to identify how they will enforce federal statutes and the United States Code.

- Have the practical force of law but can be overturned by courts as not properly applying the laws.

- Federal regulations are generally found in the Code of Federal Regulations (http://www.gpoaccess.gov/cfr/) and are first promulgated through the Federal Register (http://www.gpoaccess.gov/fr/index.html).

- Check specific department and agency web sites, such as www.hud.gov for Housing and Urban Development and http://portal.hud.gov/portal/page/portal/HUD/federal_housing_administration for FHA which is under HUD.
State Regulations

- Are drafted by State executive branch agencies to identify how they will enforce statutes and codes.

- Generally have the force of law but can be overturned by courts as not properly applying the laws.

- State regulations might be found in a State code of regulations. Example: California Code of Regulations at [http://www.oal.ca.gov/CCR.htm](http://www.oal.ca.gov/CCR.htm) with notices given at [http://www.oal.ca.gov/Notice_Register.htm](http://www.oal.ca.gov/Notice_Register.htm)

- If a California state agency issues, enforces, or attempts to enforce a rule without following the Administrative Procedures Act, the rule is called an "underground regulation." State agencies are prohibited from enforcing underground regulations. See [http://www.oal.ca.gov/Underground_Regs.htm](http://www.oal.ca.gov/Underground_Regs.htm)

- State agencies will publish helpful reprints or summaries. See [http://dre.ca.gov/pub_home.html](http://dre.ca.gov/pub_home.html) for DRE publications.
Public Benefit Requirements

- Congress or State Legislatures will adopt a program that provides some kind of incentive payment, rebate, subsidy or tax credit (a “benefit”).

- The rules of the program must be met to obtain the “benefit.”

- An executive agency might have authority to create programs and apply government funds. For example: HAFA is a non-legislative program that provides payments to borrowers and loan servicers for performing certain actions.

- Meeting program requirements is necessary to obtain the “benefit,” but failing to, or choosing not to, meet the requirements is not acting “illegally.” It simply precludes qualifying for the “benefit.”

- Therefore, traditional short sale programs determined by the note-holder and managed by the bank-servicer can continue to exist. They simply do not qualify for the HAFA “benefits” and the borrower does not have to meet the HAFA requirements.
Now You Can Recognize the Source of “Law”

- Common Law – court based, judicial law.
- Statutory Law – from legislative branch.
- Regulations – from executive branch.
- “Public benefits” – program requirements.
Looking at the Legal Concept of “Fraud”
The “flavors” of Fraud

- Civil – awards monetary compensation
  - State Law – can be common law or statutory
  - Federal Law – must be based on statutes; there is no general, federal common law (*Wheaton v. Peters*, 1834; and *Erie Railroad v. Tompkins*, 1938);

- Criminal – imposes penalties: fines and/or imprisonment; loss of license
  - State Law – criminal law is statutory (Calif. mostly in the Penal Code), but interpreted by courts
  - Federal Law – is also statutory and interpreted by courts
Civil Fraud is enforced through a civil law suit. A “plaintiff” must file a court case and sue a “defendant.”

Federal government sues for civil fraud through the Department of Justice, Civil Division, Fraud Section. See [http://www.justice.gov/civil/frauds/who_we_are.html](http://www.justice.gov/civil/frauds/who_we_are.html)

A judge or a jury decides and issues a “judgment.”

License regulators, such as DRE, can suspend or revoke licenses for fraud, but generally cannot award damages, cancel contracts, or require refunds. See [http://dre.ca.gov/cons_complaint.html](http://dre.ca.gov/cons_complaint.html)
Criminal Fraud is enforced through criminal courts at the State and Federal levels.

- **Federal** – Prosecuted by U. S. Attorneys under the Dept. of Justice (DOJ). Government owned enterprises such as Freddie Mac and Fannie Mae do not have criminal enforcement authority; must refer to DOJ for final investigation and enforcement. *But they have an “exclusionary list” (blacklist).*

- **State** – Could be prosecuted by Assistant Attorney General at State level; District Attorney at County level; or City Attorney at municipal level. Attorneys for licensing agencies, such as DRE, enforce license actions but refer criminal actions to Attorney General.
Common Law Civil Fraud

- Typical Elements of Civil Fraud:
  - An intentionally or recklessly FALSE statement of FACT. (Not of opinion or obvious sales “puffing” – such as “best house on the block”)
  - The false statement involves a MATERIAL fact.
  - Is made with the INTENT to DEFRAUD.
  - Is REASONABLY relied upon by the victim.
  - And, RESULTED in damages.
    (Must have a causal link.)
Variations of Civil Fraud

- “Negligent misrepresentation” (careless statement) rather than intentional misrepresentation.

- “Concealment” – omission to disclose a material fact with intent to defraud IF there is a DUTY to disclose.

- Duty may arise from:
  ◦ Fiduciary relationship, such as agent and principal.
  ◦ Actively hiding a fact – painting over mold or leak stains.
  ◦ Taking action to disclose some information (without a duty) but the info is misleading without a missing part.
  ◦ Statutory requirement – such as transfer disclosure statement.
The Victim’s Actions Must be Rational

- Victim must have **relied** on the statement, **AND**
- The reliance must have been **reasonable**.

  ◦ A victim “may not put faith in representations which are preposterous, or which are shown by facts within his observation to be so patently and obviously false that he must have closed his eyes to avoid discovery of the truth.” *Seeger v. Odell*, 18 Cal. 2d 409 (1941).

  ◦ Example: A dishonest buyer sends the bank old photos showing a cracked foundation when the bank has a certified contractor’s report showing a repaired, stable foundation – but the bank bases its discounted valuation on the old photos. Did the bank reasonably rely on the photos when it has newer, more reliable factual information? Obviously, NOT.
The Keys To Find Civil Fraud:

- One must show:
  - A material misrepresentation – a **LIE**, OR
  - A material omission when there is a **DUTY** to disclose, **AND**
  - Reasonable **reliance** by the “victim.”

- If one of these is missing, there is **NO** civil fraud.
This is worth repeating:

- There is NO FRAUD unless there is:
  - A LIE, OR
  - A DUTY to disclose information that is not disclosed,
  - AND
  - The victim’s RELIANCE is REASONABLE.

- If any ONE is missing, then there is NO FRAUD.
FBI Warning

The Warning states: “It is illegal for a person to make any false statement regarding . . . [it is not illegal to make true statements.]

Source: http://www.fbi.gov/pressrel/pressrel07/mortgagefraudwarning.pdf
A Look at 18 USC 1001

- 18 U.S.C. §1001 (a) states:
  - Except as otherwise provided in this section, whoever, in any matter within the jurisdiction of the executive, legislative, or judicial branch of the Government of the United States, *knowingly and willfully* --
    - falsifies, conceals, or covers up by any trick, scheme, or device a material fact;
    - makes any materially false, fictitious, or fraudulent statement or representation; or
    - makes or uses any false writing or document knowing the same to contain any materially false, fictitious, or fraudulent statement or entry; *shall be fined under this title or imprisoned not more than 5 years, or both.*

- Notice the requirements regarding falsity of material fact.

- However, **THIS** section on its face does *not* require reasonable RELIANCE. Hence, prosecutors can actually try to apply it more liberally than common law civil fraud.
A look at 18 U.S.C. §1010

18 U.S.C. §1010 states (in pertinent part):

- Whoever, for the purpose of obtaining any loan . . . with the intent that such loan or advance of credit shall be offered to or accepted by the Department of Housing and Urban Development for insurance, or for the purpose of obtaining any . . . release, or substitution of any security on such a loan, advance of credit, or for the purpose of influencing in any way the action of such Department, makes, passes, utters, or publishes any statement, knowing the same to be false, or alters, forges, or counterfeits any instrument, paper, or document, or utters, publishes, or passes as true any instrument, paper, or document, knowing it to have been altered, forged, or counterfeited, or willfully overvalues any security, asset, or income, shall be fined under this title or imprisoned not more than two years, or both.

- **Once again:** falsity is required.

- Interestingly, overvaluation can be a crime but it does not include undervaluation.
Similar requirements will be found in the other statutes

Sampling of other statutes:

• 1014 – “Whoever knowingly makes any false statement or report, or willfully overvalues any land, property or security, for the purpose of influencing in any way the action of the Farm Credit Administration, . . .”

• 1028 – relates to “fraud” in connection with identification documents. Either the documents or intended use require some degree of falsity.

• 1341 – “intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises . . . to be sent or delivered by the Postal Service . . .”

• 1342 – “. . . requests to be addressed by, any fictitious, false, or assumed title, name, or address . . .”
And for “bank fraud”

- 18 USC §1344 – Bank fraud – states:
  - Whoever knowingly executes, or attempts to execute, a scheme or artifice - (1) to defraud a financial institution; or (2) to obtain any of the moneys, funds, credits, assets, securities, or other property owned by, or under the custody or control of, a financial institution, by means of false or fraudulent pretenses, representations, or promises; shall be fined not more than $1,000,000 or imprisoned not more than 30 years, or both.

  ◦ Once again: there is no violation for truthful information.

  ◦ Note also: this applies to “obtaining any of the moneys,” not to obtaining a release of security or of a liability.
Flopping, Short Sales, and Broker Price Opinions

- The perpetrators collude with appraisers or real estate agents to undervalue the property using an appraisal or a broker price opinion to further manipulate the price down (the flop) to increase their profit margin when they later flip the property. They negotiate a short sale with the bank or lender, purchase the property at the reduced price and flip it to a pre-selected buyer at a much higher price.

- If this statement is about the investor’s truthful data provided by an appraiser or agent the investor hired to prepare a truthful report, then NO FRAUD.

- If this is about the investor bribing or threatening the bank’s appraiser or BPO agent, then there is a BIG problem. Don’t do this. Not what we teach.

- If the buyer is pre-selected, then there likely is fraud.
Source: same FBI web site.

**Illegal Property Flipping Scheme**
- Illegal property flipping . . . involves the purchase and subsequent resale of property at greatly inflated prices. *The key to this scheme is the fraudulent appraisal, which occurs prior to selling the property. The artificially inflated property value enables the purchaser to obtain a greater loan than would otherwise be possible.* Subsequently, a buyer purchases the property at the inflated rate. The difference between what the perpetrator paid for the property and the final purchase price of the home is the perpetrator’s profit.

Again, not what we teach. Note even part of the DRE Newsflash.

**Simple:** don’t get involved with fraudulent appraisals to obtain or discount a loan (or for any other purpose). *Pretty tough to do with HVCC anyway.*
Same FBI web site source.

*Short Sale Schemes*
- . . . the perpetrator uses a straw buyer to purchase a home *for the purpose of defaulting on the mortgage*. The mortgage is secured with fraudulent documentation and information regarding the straw buyer. Payments are not made on the property loan, causing the mortgage to default. Prior to the foreclosure sale, the perpetrator offers to purchase the property from the lender in a short sale agreement. The lender agrees without knowing that the short sale was premeditated.

Again, this is a pretty obvious wrong; is not what we teach and is not discussed in the DRE Newsflash.
Naturally, opinions vary

<table>
<thead>
<tr>
<th>Obviously, there are opinions all over the map.</th>
</tr>
</thead>
<tbody>
<tr>
<td>The role of brokers, agents and investors is not to adopt an opinion simply because it “sounds official.” <strong>It must make legal sense.</strong></td>
</tr>
<tr>
<td>The more one knows about the law, the less sense many of these articles make.</td>
</tr>
<tr>
<td>The bias of many regulators and authors is to over-simplify to avoid more work. Fear creates inaction, so they have less to regulate.</td>
</tr>
<tr>
<td>My bias is to find or create accurate legal analysis that encourages commerce and private market solutions to the government stimulated “housing crisis.”</td>
</tr>
</tbody>
</table>
Sources to keep up to date

- **www.CaliforniaShortSaleLawyer.com**
  - Free blog about California and national short sale issues.
  - Register online to receive notices of new articles and to post comments or questions on the blog.

- **Real Estate Strategies Institute, Inc. (“RESI”)**
  - [www.theresi.com](http://www.theresi.com) or [www.realestatestrategiesinstitute.com](http://www.realestatestrategiesinstitute.com)
  - Choose one or more *free* news lists on the “Sign Up” page – high on content, low on advertising and “offers”. Topics:
    - Short Sale Quick-turn Investing
    - General Real Estate Investing
    - “Wealth Law” from Ballard Law Office