No. 08-1421

IN THE UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

MARION D. JOHNSON and VIVIAN Y. JOHNSON,
Plaintiffs-Appellants,
v.

D AND D HOME LOANS CORPORATION, JASON C. WASHINGTON
and WARREN MIKE ROBINSON,
Defendants-Appellees.

On Appeal from the United States District Court
for the Eastern District of Virginia

BRIEF FOR APPELLANTS
MARION D. JOHNSON and VIVIAN Y. JOHNSON

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CORPORATE DISCLOSURE STATEMENT

Both plaintiffs are individual persons; therefore, no corporation owns any interest in the plaintiffs. The plaintiffs are unaware of any publicly held corporation, whether or not a party to the present litigation, that has a direct financial interest in the outcome of the litigation by reason of a franchise, lease, other profit sharing agreement, insurance, or indemnity agreement.

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JURISDICTIONAL STATEMENT

Defendant Jason C. Washington's ("Washington") compliance with the Truth in Lending Act ("TILA"), 15 U.S.C. § 1601 *et seq.*, during his foreclosure prevention transaction with Marion D. Johnson and Vivian Y. Johnson ("the Johnsons") is at issue in this case. The district court therefore had original jurisdiction over the Johnsons' TILA claim based on 28 U.S.C. § 1331, as it arises under the laws of the United States, and supplemental jurisdiction over the remaining claims based on 28 U.S.C. § 1367. Accordingly, the district court had jurisdiction based on 28 U.S.C. § 1441 when the defendants removed the Johnsons' action from the Circuit Court of the City of Norfolk.

This Court has jurisdiction based on 28 U.S.C. § 1291, which provides this Court's jurisdiction over a final judgment of a United States District Court. The district court entered judgment in favor of Washington's counterclaim on March 14, 2008. That judgment resolved the last remaining claim of relief in the case, and it therefore constituted the district court's entry of final judgment. Fed. R. Civ. P. 54(b). The Johnsons timely filed this appeal on April 11, 2008.

STATEMENT OF THE ISSUES

1) Whether the purported conditional sale transaction created an equitable mortgage under Virginia common law, thereby requiring the defendants to comply with federal and state borrower protection statutes?

2) Whether statements made in the course of the transaction constituted fraud if the transaction constituted a sale rather than creating an equitable mortgage?

STATEMENT OF THE CASE

This appeal is filed from the district court's grant of summary judgment in favor of D and D Home Loans Corporation ("D&D"), Washington, and Warren Mike Robinson ("Robinson") as to claims brought against them by the Johnsons, and from the district court's grant of summary judgment in favor of Washington on his breach of contract counterclaim against the Johnsons.

The Johnsons filed this case after seeking the defendants' assistance to prevent foreclosure by refinancing their home loan only to have the defendants take almost all of their home's equity. The Johnsons filed a twelve-count complaint in the Circuit Court of the City of Norfolk on March 27, 2007, alleging that through this transaction the defendants had committed fraud; a breach of contract; a breach of fiduciary duty and negligence; unlawful conversion; unjust enrichment; a breach of the implied covenant of good faith and fair dealing; conspiracy; violations of TILA; violations of state and federal real estate settlement statutes; and prohibited predatory lending practices under the Virginia Mortgage Lender and Broker Act ("MLBA"), Va. Code Ann. § 6.1-422.[1] JA14-53. The defendants removed the action to the United States District Court for the Eastern

[1] The complaint included as defendants the current mortgage lien holder, the trustee to that mortgage lien, the settlement company used in the transaction, and an employee of the settlement company in addition to D&D, Washington, and Robinson. The plaintiffs voluntarily dismissed their claims against those additional parties.

District of Virginia on May 2, 2007. Washington filed a two-count counterclaim on May 21, 2007 alleging that the Johnsons had breached the contract created as part of the transaction. JA54-58.

In two opinions filed on December 6, 2007, the district court held that the plaintiffs had adequately pled their fraud and conspiracy counts and that Virginia Code § 6.1-422.1(C) provides borrowers with a cause of action when a mortgage lender or broker engages in a predatory lending practice prohibited by § 6.1-422. The district court, accordingly, rejected defendants' motions to dismiss those counts for failing to state a claim for which relief can be granted. JA59-81.[2]

After a period of discovery, which included two days of oral depositions from each plaintiff and an oral deposition from Washington, the defendants filed for summary judgment on all remaining counts. The parties disputed numerous facts in their memoranda addressing summary judgment. JA319-22, 330-32.

In two opinions filed on January 23, 2008, the district court granted summary judgment in favor of the defendants on all of the remaining claims brought by the plaintiffs. JA430-66.

The district court recognized that resolving the TILA claim against Washington and the MLBA claim against D&D and Robinson depended on

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[2] The district court, however, dismissed the count alleging a breach of the implied covenant of good faith and fair dealing and the independent counts seeking the imposition of a constructive trust and resulting trust and seeking declaratory relief.

whether the transaction created an equitable mortgage. JA441-42, 445, 462. The court held that no equitable mortgage existed, and therefore the plaintiffs' statutory claims failed, because no debt or borrower-lender relationship existed. JA444, 464-65. The district court deemed it unnecessary to look to any "additional circumstances" that surrounded the transaction because no debt existed. JA442, 444, 463, 465.

The district court held the fraud allegations against D&D and Robinson were not viable because the alleged statement "you can refinance in twelve to thirteen months" was true and the statements "Washington does not want your house" and "I do not want your house" were not statements of "present, pre-existing facts but opinions and expressions of desires." JA438. The district court also held the fraud claim was precluded because of "the Johnsons' failure to read any of the documents they were signing." JA439.

Finally, in an opinion filed on March 12, 2008, the district court granted summary judgment in favor of Washington on his breach of contract counterclaim against the Johnsons and awarded $10,733.20 in damages. JA486-94.[3]

This appeal followed.

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[3] Washington subsequently filed an untimely motion seeking attorneys' fees and prejudgment interest, which the district court denied in a May 2, 2008 opinion.

STATEMENT OF FACTS

Marion Johnson, a minister, and Vivian Johnson, a preschool director, paid approximately $130,000 in December 1995 to purchase a home on 907 Elm Court in Norfolk, Virginia that served as the couple's residence. JA164. They purchased the house under a program that assisted families with limited incomes to become homeowners. JA366-67. By the spring of 2005, the couple had lived in their home for almost ten years and seen its value appreciate to $260,000. JA50. Nearly $100,600 of that value represented equity built by the Johnsons, and the remaining $159,400 represented the outstanding balance on a mortgage loan with NovaStar Mortgage, Inc. ("NovaStar"). JA51.

Because of changes in the regularity of Vivian Johnson's employment income, the Johnsons fell two payments behind on the mortgage payments to NovaStar during the spring of 2005 and believed that foreclosure was imminent. JA107, 152, 188, 311. As a result, the Johnsons wished to refinance the NovaStar loan in order to cure the missing payments and enable them to resume making regular monthly payments once their income returned to normal. JA188-89. An acquaintance referred Marion Johnson to local mortgage broker Robinson, who was president of D&D, to refinance the mortgage. JA192-93.

Robinson and the Johnsons met at D&D's Norfolk office in the spring of 2005. According the Johnsons' testimony, they met with Robinson "looking to get a loan to refinance" their NovaStar mortgage. JA248, 372. Robinson acknowledges that the Johnsons came to him seeking a mortgage loan. JA276. Although Robinson did not offer the Johnsons financing from a traditional mortgage lending company, Robinson explained that it would be possible to refinance the mortgage and prevent foreclosure by entering into an arrangement with an investor with whom Robinson worked. JA195-96. According to Vivian Johnson, Robinson explicitly called this transaction a loan. JA172, 178, 392-93.

The Johnsons never intended to work with Robinson to sell the house. As Marion Johnson sensibly explained, "if I was going to sell my house I wouldn't go to a mortgage company to sell my house." JA233. Vivian Johnson recounted that the topic of selling their home "never came up in a conversation" with Robinson. JA150. She explained that no such discussions arose "because we went there to get help to keep our house, not to sell our house." JA141, 143. Robinson even acknowledges that he did not intend to create a transaction that would cause the Johnsons to lose possession of their house. JA277. Instead, Marion Johnson understood the "investor" arrangement to be a type of "creative financing" then prevalent in the mortgage lending industry. JA196, 208.

The Johnsons had a further meeting with Robinson in May 2005. At this meeting, Robinson explained that—in Vivian Johnson's words—he "did not want my house . . . that no one wants my house." JA113. Vivian Johnson testified that at this meeting she "was under the impression I was getting a loan to keep my house, to bring it up current." JA369. According to the Johnsons, Robinson explained that he was "here to help" the couple, particularly because he saw it as part of his duty as a fellow Christian to help the Johnsons avoid foreclosure, and he explicitly appealed to their shared Christian faith. JA113, 115, 150, 252, 370, 385, 404-05, 408. Vivian Johnson vividly recounted Robinson's sales pitch:

> I put so much attention on what he was saying and his sincerity in what he was saying, sir, and I accepted what he was saying as a fellow Christian, and telling me that he was a Christian. He told me he was a Christian. He told me he wanted to help me. He told me he didn't want my house. He told me Mr. Washington didn't want my—my house. His wife told me everything was going to be okay. We're going to help you. Don't worry about it, because I was crying. I was crying. Don't cry. Everything is going to be—it's going to work out with you.
>
> Sir, I trusted them. Do you understand what I'm saying? I'm not all about that. I trusted them. He made me believe that he was telling the truth, that Mr. Washington was a person that I could trust, that—by what he was saying, that he didn't want my house, Mr. Washington didn't want my house. All they wanted to do, sir, was to help us. We went there for help. That's all we went there for. Do you understand what I'm saying? We went there for help. We didn't go for all this, and we wasn't trying—we are not people that are vindictive, but he deceived me. He made me believe that he wanted to help me, and I put all my energy—all I could hear was somebody finally wanted to help us, somebody—another Christian wanted to help us, and that's why I felt—I felt he was my brother and he wanted to help me, and it didn't work out, sir. It did not work out. Do you understand what I'm saying?

JA409-10.

At that May meeting, Robinson also introduced the Johnsons to the "investor"—Washington—who would provide the financing. JA310. According to Vivian Johnson, Robinson "told us there were people in his organization, that work with him, that they would use their credit, and they help people and lend you the money to help you get back on your feet, in assisting you to help you to keep your house," and that Washington "was going to be the one to give us the loan." JA118-19, 373. As she understood the transaction, "because our credit was not good enough to obtain a loan from the mortgage company so [Washington] was standing in place of the mortgage company." JA395. Washington acknowledges that he knew the transaction with the Johnsons was intended to "help . . . out" a couple that was facing foreclosure. JA311. During this meeting, Robinson presented the Johnsons with documents he had previously prepared, including one labeled an "Offer To Purchase Real Estate." JA47-49. Vivian Johnson testified that she believed the purpose of signing the document was to allow them to obtain a loan. JA375-76.

Robinson instructed the Johnsons to attend another meeting on June 30, 2005, at which the Johnsons signed several documents that they had never previously seen and had no role in preparing. JA212-13. These documents included a quitclaim deed purporting to transfer absolute ownership of their house to Washington and a HUD1 Settlement Statement showing that the sales price of the house was $212,800. JA45 line 101, JA282-83. The Johnsons had never discussed this purported sales price with Robinson or Washington. JA203-04. Vivian Johnson testified that she believed she was signing those documents to enable the couple to get a loan. JA382. The Johnsons also received a $44,410.56 check, JA45 line 603, and Robinson explained that the Johnsons should cash it and return the next week with its proceeds to complete the transaction. Robinson was specific that the exchange of money needed to involve cash. JA135, 224-25. The Johnsons had some difficulty satisfying that condition because the first bank they visited did not have such a large amount of currency on hand and a second bank tried to dissuade them from obtaining such a large sum of cash. JA133-35, 224-25, 378.

The Johnsons returned to D&D's office the following week, on July 6, 2005, with the $44,410.56 in currency. JA215-16, 224-36. After counting the cash, Robinson kept most of it for himself, without any negotiation over the amount he would keep, and returned roughly $8,000 to the Johnsons. JA137-39. The Johnsons used this remaining $8,000 in cash to perform maintenance tasks on their house. JA407.

Robinson had the Johnsons sign additional documents including a "Contract For Deed of Real Property." JA40-43. Its terms required the Johnsons to repay Washington $235,559.68 over the course of thirteen months—$1896.64 each month for twelve months and a final balloon payment of $212,800 at the end of the term if they wished to retain ownership of their house. JA40-42 ¶¶2, 8. That document also stated it represented a "purchase money note delivered by [the Johnsons] to [Washington] . . . secured by a contract of deed for the property." JA40 ¶1.2.

During the course of their meetings with Robinson and Washington, the Johnsons were repeatedly told "if you continue paying your—your mortgage payments between the 12 and 13 months you could come back and refinance this—this home." JA171, 213, 270, 393, 397, 399, 405. Consistent with those representations, the "Contract For Deed of Real Property" gave the Johnsons the right to "refinance" the debt on their house within thirteen months in exchange for a $36,279 "down payment" and timely monthly payments for the subsequent twelve months. JA41-42 ¶¶5, 8. Robinson acknowledged that he "quot[ed] and/or paraphrase[ed]" these provisions providing for "refinanc[ing]" the home during his meetings with the Johnsons. JA277.

The Johnsons' monthly payment obligation under the "Contract For Deed of Real Property" was directly correlated to the payments that were owed on two Finance America mortgage loans brokered by Robinson as part of the transaction. JA40 ¶2, 45-46. The contract provided that this payment obligation did not represent a landlord-tenant relationship. JA42 ¶5.1. The agreement also stated that the Johnsons were responsible for all insurance and tax payments during the course of that year, as well as property maintenance. JA40-42 ¶¶2, 2.2, 5.

The Johnsons are clear that during the spring of 2005 they always believed the transaction was refinancing their NovaStar mortgage rather than selling their home. Marion Johnson testified that "it was my impression we were doing the refinancing the whole time." JA249. And Vivian Johnson was quite emphatic on this point when pressed by the defendants' lawyer:

> A. And I was told that I was getting a loan, sir.
> Q. But—but—
> A. I did not think I was selling my house, sir.
> Q. All right.
> A. At no time did I think I was selling my house.
> Q. But even though you were referred to as a seller—
> A. I did not think I was selling my house, sir.
> Q. But do you understand there is, obviously, a discrepancy between what you're telling me and what the documents say?
> A. I understand that, sir, what you're saying sir, but I did not at one time think that I was selling my house.
> Q. Okay. So—let me ask you again, did you read this before you signed it? Do you want to—do you want to change your answer?
> A. I did not think I was selling my house, sir.

JA122, 377. Moreover, she testified that Robinson used lending language as well: "Mr. Robinson told me we was getting a loan." JA393. Nevertheless, the Johnsons did not receive disclosures pursuant to TILA, MLBA, or any other mortgage lending law.

The Johnsons continued living in the house and began making monthly payments to Washington, which they designated as mortgage payments on the face of the checks. JA158. In the months following the transaction, they grew increasingly disturbed by Washington's unprofessional manner of accepting the monthly payments: he only provided receipts upon the Johnsons' insistence and arranged to collect payments on an ad hoc basis using locations such as the parking lot at a Popeyes fast food restaurant. JA145, 173-74, 239-40. Consequently, they made ultimately unsuccessful attempts to satisfy Washington. JA175, 258. Finally, the Johnsons informed Washington in a March 2007 letter that they wished to rescind the transaction pursuant to TILA. JA52-53.

The transaction had a financially ruinous design. The Johnsons were expected to repay Washington $235,559.68 within thirteen months if they wished to retain ownership of the house in exchange for his advance of $176,521.06[4] on their behalf. *See supra* pp. 10-11. That $59,000 difference represents more than 33% of Washington's investment and corresponds to an annual interest rate of 28% over the thirteen-month term of the "Contract For Deed of Real Property." *See* 15 U.S.C. § 1606(a) (defining annual percentage rate for purposes of TILA).

[4] This amount represents the $8,121.62 difference between the check that the Johnsons received at the closing and the portion of these proceeds that they were required to repay as the "down payment" on the "Contract For Deed of Real Property," JA40 ¶1.1, JA45 line 603, plus $1,254.89 in delinquent property taxes paid as part of the transaction, JA46 line 1303, plus the $166,600.05 payoff to NovaStar, JA45 line 504.

Moreover, the Johnsons realized from the transaction less than $9,400[5] of the $100,600 in home equity that they owned in the spring of 2005 before meeting Robinson and Washington—equity they would have owned even had NovaStar foreclosed. The rest of this equity, if the transaction was a sale, became the property of Robinson and D&D, which earned at least $9,500 from the transaction, JA46 lines 803-806, and Washington.

[5] The property tax payment plus the difference between the closing check and the contract "down payment." *See supra* note 4.

SUMMARY OF THE ARGUMENT

The equitable mortgage doctrine prevents abuses against borrowers by considering parol and other extrinsic evidence to determine whether written forms that normally create a sale truly represent a lending transaction. The doctrine answers this question by investigating whether a debt exists between the parties to the transaction—either a preexisting obligation or one created by the transaction—and examining the circumstances of the transaction that shed light on the parties' intent. Virginia courts have held that such a look behind the forms is particularly necessary in transactions purporting to create conditional sales, where it is clear that the parties intended that the original homeowner would retain ownership if, but only if, he repaid a sum of money.

Virginia case law dictates that the Johnsons' obligation to repay Washington in order to retain ownership was the debt necessary to create an equitable mortgage. Moreover, the circumstantial signs of the parties' intent traditionally consulted by Virginia courts overwhelmingly support the Johnsons' transaction creating an equitable mortgage. The district court's holding that the Johnsons' transaction failed to create a debt for purposes of the equitable mortgage doctrine conflicts with the longstanding analysis of courts both in Virginia and other jurisdictions when presented with similar transactions. This legal error and the district court's failure to examine the circumstances surrounding the transaction require this Court to reverse the grant of summary judgment.

If the Johnsons' transaction did not create an equitable mortgage, then Robinson and D&D committed fraud. Their statements to the Johnsons—including their statements of intent that constitute factual representations under Virginia fraud jurisprudence—are absolutely inconsistent with a transaction that caused the Johnsons to give up ownership of their house. Virginia's fraud doctrine prevents them from luring the Johnsons into signing documents based on such misrepresentations and then relying on the same documents to absolve them of those misrepresentations. Summary judgment on the fraud claims must be reversed because the district court failed to recognize the factual inaccuracy in the statements of Robinson and D&D and viewed the transaction's documents as immunizing them from fraud liability.

STANDARD OF REVIEW

Summary judgment is only appropriate when no issues of material fact—issues "that might affect the outcome of the suit under the governing law"—exist and the moving party is entitled to judgment as a matter of law. *Anderson v. Liberty Lobby*, 477 U.S. 242, 248 (1986). When reviewing facts presented supporting a motion for summary judgment, a court must construe all facts in the light most favorable to the non-moving party. *Seabulk Offshore, Ltd. v. Am. Home Assurance Co.*, 377 F.3d 408, 418 (4th Cir. 2004). This Court's review of the district court's award of summary judgment is de novo, "applying the same standards that the district court was required to apply," and all facts and inferences from those facts must be viewed in the light most favorable to the Johnsons. *BB&T Corp. v. United States*, 523 F.3d 461, 471 (4th Cir. 2008).

ARGUMENT

The Johnsons went to a mortgage broker in the spring of 2005 to save their house from foreclosure and protect their $100,600 in home equity. The Johnsons obtained what they believed was a loan to pay off their prior mortgage, after hearing the mortgage broker explain that neither he nor the lender had any interest in owning their house and that they could refinance in a year. The Johnsons started making mortgage payments to the lender, and they continued to pay the insurance and taxes and to maintain and improve the property like the typical homeowner. Moreover, their agreement with the lender, which stated it represented a "purchase money note," made them responsible for repaying him within thirteen months or else they would lose the house.

Thus, the realities of the transaction matched a lending transaction. Although the Johnsons signed documents formally purporting to conditionally sell their house—without any negotiation over price and in exchange for retaining less than one-tenth of their home equity—Virginia's equitable mortgage doctrine does not allow the documents to hide what these circumstances demonstrate was a lending transaction.

I. THE EQUITABLE MORTGAGE DOCTRINE SERVES AS A VENERABLE AND VIBRANT PRINCIPLE IN VIRGINIA JURISPRUENCE TO PROTECT BORROWERS.

As long recognized by American courts, lenders sometimes look for ways to avoid borrower protection laws by "cloth[ing] the transaction with the forms of a sale" that nominally create a non-lending transaction but nevertheless functionally provide borrowers with credit. *Russell v. Southard*, 53 U.S. (12 How.) 139, 152 (1851); *see also Christopher v. Cox* (*In re Cox*), 493 F.3d 1336, 1340 n.10 (11th Cir. 2007) (per curiam) ("[L]enders often seek to disguise mortgages as conveyances to avoid the pro-mortgagor regime of law."). Lenders can engage in such masquerades because borrowers are typically in no position to challenge efforts to hide the true nature of the transaction. As the United States Supreme Court first recognized more than 150 years ago:

> [T]he distress for money under which [the appellant] then was, places him in the same condition as other borrowers, in numerous cases reported in the books, who have submitted to the dictation of the lender under the pressure of their wants; and a court of equity does not consider a consent, thus obtained, to be sufficient to fix the rights of the parties. Necessitous men . . . are not, truly speaking, free men; but, to answer a present emergency, will submit to any terms that the crafty may impose upon them.

Russell, 53 U.S. (12 How.) at 152 (internal quotation marks omitted).[6]

But courts have not allowed borrower protections to be rendered illusory by such means. Instead, they have applied the equitable mortgage doctrine to rip the disguise off transactions really intended as loans. As Virginia's supreme court observed more than 130 years ago, equitable principles make it necessary to "look[] at the substance rather than the form of things" in transactions that are formally designated as sales but functionally represent loans. *Snavely v. Pickle,* 70 Va. (29 Gratt.) 27, 34 (1877). Accordingly, as the United States Supreme Court explained more than 150 years ago, in cases for which "the transaction was, in substance, a loan of money upon the security of the [land] . . . a court of equity is bound to look through the forms in which the contrivance of the lender has enveloped it, and declare the conveyance of the land to be a mortgage." *Russell*, 53 U.S. (12 How.) at 153, *cited with approval in Snavely*, 70 Va. (29 Gratt.) at 31. The Court explained that ignoring the forms of the transaction is necessary because "it is not to be forgotten, that the same language which truly describes a real sale,

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[6] Such "necessitous men" are certainly still present today, when a skyrocketing number of borrowers are facing the desperation brought about by impending foreclosures and consequently looking for any possible source of cash to cure delinquencies on their mortgage loans. *See, e.g., All Things Considered: Facing Foreclosure, One Home at a Time* (NPR radio broadcast Apr. 23, 2008), *available at* http://www.npr.org/templates/story/story.php?storyId=89856332 (detailing the struggles of a single mother in Florida who is "facing foreclosure and for months has desperately looked for a way to save her home, so far without success," which it describes as "an extreme version of one that's happening to millions of people across the country" facing foreclosure).

may also be employed to cut off [borrower protections] . . .; that it is the duty of the court to watch vigilantly these exercises of skill, lest they should be effectual to accomplish what equity forbids." *Id*. at 151.

Virginia's supreme court has recognized the equitable mortgage doctrine since the Commonwealth's earliest days. *See Robertson v. Campbell*, 6 Va. (2 Call) 421, 429 (1800). And the doctrine continues to be vibrant in modern American jurisprudence. *See, e.g.*, *In re Cox*, 493 F.3d at 1340 (describing the doctrine's status as "black letter law"); *Redic v. Gary H. Watts Realty Co.*, 762 F.2d 1181, 1185-86 (4th Cir. 1985) (reviewing the equitable mortgage doctrine as incorporated in North Carolina's common law); *Restatement (Third) of Property (Mortgages)* §§ 3.2, 3.3 (1997) (devoting two sections to the doctrine).[7] Virginia applies the doctrine consistent with how it is generally applied in American jurisprudence, as articulated in other states' case law, treatises, and the Restatement. *See, e.g.*, *Johnson v. Johnson*, 33 S.E.2d 784, 788-89 (Va. 1945)

[7] Not only is the doctrine vibrant, it is relevant today: The increasing foreclosure rate in recent months has brought out numerous "[f]oreclosure con artists" who "promise to 'rescue' homeowners from foreclosure" but really "take your money, ruin your credit record, and wipe out any equity you have in your home." Comptroller of the Currency, Consumer Advisory 2008-1, OCC Consumer Tips for Avoiding Foreclosure Rescue Scams 1 (2008), *available at* http://www.occ.treas.gov/ftp/ADVISORY/2008-55a.pdf. One of the ways these "scams" regularly operate is by "people posing as mortgage brokers or lenders and offering to refinance your loan so you can afford the payments" but in fact "trick[ing] you into signing over the ownership of your home by saying that you are signing documents for a new loan." *Id*.

(adopting equitable mortgage jurisprudence from treatises); *Holladay v. Willis*, 43 S.E. 616, 617-18 (Va. 1903) (adopting equitable mortgage jurisprudence from North Carolina, Missouri, and West Virginia case law).

To dispense with lenders' form-over-substance masquerade, the equitable mortgage doctrine renders extrinsic and parol evidence admissible to demonstrate "that a deed absolute on its face may be by such evidence converted into a mortgage." *Tuggle v. Berkeley*, 43 S.E. 199, 201 (Va. 1903). Indeed, it is necessary for a court evaluating an equitable mortgage claim to review the deed "in the light of the circumstances which surrounded the contracting parties and their disclosed intentions, acts and conduct prior to, at the time of, and subsequent to the execution thereof." *Johnson*, 33 S.E.2d at 788.

Transactions that combine a deed with an agreement giving the grantor a means to reacquire formal ownership of the property receive special scrutiny from Virginia's equitable mortgage doctrine. Virginia's supreme court specified that "it is *usually requisite* to resort to *parol evidence*, extrinsic to the deed creating the estate, to determine the true character of the transaction" that involves a purported conditional sale.[8] *Id.* at 789 (quoting 1 Raleigh C. Minor, *The Law of Real Property* § 580 (Frederick Deane Goodwin Ribble ed., 2d ed. 1928)) (emphasis added). Such increased scrutiny is necessary because "the attempt is not unfrequently [sic] made to give what is really in purpose and intent a mortgage, the aspect of a conditional sale." *Id*. (quoting 1 Minor, *supra*, § 580).

Additionally, Virginia's supreme court has repeatedly held that when presented "[d]oubtful cases" of whether a transaction clothed as a conditional sale was indeed a bona fide sale or actually a mortgage transaction, Virginia law will "generally declare [them] to be mortgages." *Id*. (quoting 1 Minor, *supra*, § 580); *see also Tuggle*, 43 S.E. at 201 ("It is a well-established rule of equity that in cases of doubt such instruments are construed as mortgages. All the authorities agree as to that."). As a leading mortgage law treatise observes, "to permit the grantor to establish that the [conditional sale] transaction is a mortgage clearly does not contradict the written documentation to the same degree as in the deed absolute situation where the successful grantor is allowed to take away real estate from a

[8] In some cases the conditional nature of the purported sale is clear, and this parol evidence is used only to show that it was indeed a mortgage transaction, *see Johnson*, 33 S.E.2d at 787-88 (examining parol evidence concerning a written repurchase agreement); in other cases this parol evidence may both establish the conditional nature of the purported sale and the transaction's true mortgage nature, *see Snavely*, 70 Va. (29 Gratt.) at 27 (detailing the parol agreement to reconvey the property upon repayment).

grantee who has an apparently indefeasible title to it." Grant S. Nelson & Dale A. Whitman, *Real Estate Finance Law: Hornbook Series* § 3.18, at 68 (5th ed. 2007).

The combination of documents signed by the Johnsons during the course of their transaction with Washington purported to create just such a conditional sale. Accordingly, the Johnsons' transaction faces heightened scrutiny.

II. THE FORECLOSURE PREVENTION TRANSACTION ENGINEERED BY DEFENDANTS CREATED AN EQUITABLE MORTGAGE.

The equitable mortgage doctrine disregards a sales transaction's form when the parties intended the deed to serve as security for a debt. The doctrine requires courts to examine both the intent of the parties and whether a debt exists to determine whether the deed served as security. *Hunter v. Bane*, 149 S.E. 467, 468 (Va. 1929).[9] The debt necessary to sustain an equitable mortgage "may be antecedent to, *or created contemporaneously with* the mortgage." *Snavely*, 70 Va. (29 Gratt.) at 35 (emphasis added). Because the district court contravened well established Virginia law by holding that the purported conditional sale transaction

[9] Although the United States Bankruptcy Court for the Eastern District of Virginia has suggested that the debt inquiry is a precondition to conducting the intent inquiry, *see Seven Springs, Inc. v. Abramson* (*In re Seven Springs*), 159 B.R. 752, 756 (Bankr. E.D. Va. 1993) (citing *Hunter*, 149 S.E. at 468-69), *aff'd*, 35 F.3d 556 (4th Cir. 1994) (unpublished table decision), nothing in *Hunter* or any other decision by Virginia's supreme court specifies that the circumstantial evidence relevant to the intent of the parties cannot inform the analysis of whether a debt existed. To the contrary, the supreme court has explicitly held that under the equitable mortgage doctrine a debt "is implied if it can be otherwise shown to be a mortgage." *Tuggle*, 43 S.E. at 201.

did not create a debt and ignored the transaction's circumstances indicating the parties' intent, it erred in granting summary judgment to the defendants on the equitable mortgage question.

A. The Obligation To Reimburse the Payoff of a Prior Mortgage Loan in Order To Maintain Home Ownership Is the Equitable Mortgage's Underlying Debt.

By the terms of their transaction with Washington as memorialized in the "Contract for Deed of Real Property," the Johnsons were obligated to pay $235,559.68 over the course of thirteen months in order to retain ownership of their house in exchange for his advance of $176,521.06. *See supra* pp. 10-11, 13. Like any other home loan refinance, Washington's advance satisfied the Johnsons' outstanding mortgage loan. The consequence of the Johnsons' failure to make their payments to Washington was the same as any other home loan borrower faces upon default: the loss of their home. Consequently, Washington's ability to gain absolute, indefeasible title to the property secured his repayment by the Johnsons either in the form of cash payments or proceeds from a sale of their house. Even the explicit terms of their agreement spoke in terms of a debt obligation and a security interest: It stated that it represented a "purchase money note delivered by [the Johnsons] to [Washington] . . . secured by a contract of deed for the property." JA 40 ¶1.2.

The Johnsons' repurchase provision was a sufficient obligation for purposes of Virginia's equitable mortgage doctrine. This proposition has been conclusively established by Virginia's supreme court in a quartet of equitable mortgage cases: *Snavely v. Pickle*; *Tuggle v. Berkeley*; *Magee v. Key*; and *Johnson v. Johnson*.

In *Snavely*, an economically distressed homeowner had deeded his property to Pickle in exchange for Pickle repaying the homeowner's outstanding mortgage debt to an otherwise unrelated individual, Davis. 70 Va. (29 Gratt.) at 29. The deed to Pickle was absolute, but the homeowner maintained that Pickle's oral agreement to reconvey the land to the homeowner once he repaid Pickle for the advance created an equitable mortgage. *Id*. at 41. The court, reversing the trial court's determination that the transaction did not create an equitable mortgage, held that:

> The agreement that Pickle should advance for the appellant to Davis the amount of his debt and interest, and the actual payment of the same by Pickle under the agreement, created a debt, and made the appellant Pickle's debtor for the amount so advanced. There was no necessity that Pickle should take a written obligation for the repayment of this sum, for the amount was fixed and clearly ascertained by the trust deed to Davis. . . .
>
> . . . The land as security was ample, the payment of annual interest in the form of rents was provided for, and if at any time Pickle desired payment of the principal sum and the appellant were unable to make it, he had his plain remedy by bill to foreclose.

Id. at 35-36.[10]

Similarly, in *Tuggle*, the homeowner deeded the property to Tuggle in exchange for him satisfying the homeowner's outstanding tax lien. The transaction also provided that Tuggle would reconvey the property to the homeowner if she repaid him for that advance. *Tuggle*, 43 S.E. at 199-200. Tuggle argued that this transaction could not constitute an equitable mortgage because "there was no debt, that there is no covenant or promise to pay by the grantor." *Id*. at 201. Although the court agreed that "[l]ooking to the face of the deed alone, this is certainly true; there is no express promise to pay the debt," the court held that the debt necessary to create an equitable mortgage transaction can be "either express or implied." *Id*. Moreover, the court observed that while "there was no antecedent debt" between the parties to the deed, the consideration for the deed was "a promise or undertaking on the part of the grantee to pay a pre-existing debt of the grantor, and it is conceded that he paid this debt for her." *Id*. Consequently, the court held that the purported conditional sale constituted a debt transaction—based on an implied promise to repay—when Tuggle paid off the homeowner's preexisting debt. *Id*.

[10] The lack of a written debt agreement can serve as *one* factor considered when reviewing a transaction's circumstances to determine the parties' intent. *See Snavely*, 70 Va. (29 Gratt.) at 35 ("The absence of a written obligation is sometimes adverted to as tending to show that a conditional or defeasible sale, and not a mortgage, was intended. This circumstance is certainly entitled to *some weight*, but alone has *no great significance*." (emphases added)); *see also infra* Section II.B (explaining how the doctrine reviews a transaction's circumstances for the parties' intent).

Likewise, in *Magee*, 191 S.E. 520 (Va. 1937), the homeowner deeded the property to Magee in exchange for him paying the balance she owed to reacquire her property at a public auction. Along with the deed, the parties entered into a contract that provided Magee would reconvey the property to the homeowner if she repaid him before a certain date. That contract also provided that if the homeowner "failed to perform this condition that the titles to the property would be forever vested in Magee" but imposed no additional requirement that the homeowner make the payment. *Id*. at 523. The supreme court held this created an equitable mortgage. *Id*. at 524.

Finally in *Johnson*, the court—in its most recent articulation of the equitable mortgage doctrine—examined a transaction in which the homeowner deeded his property to Johnson in exchange for him taking responsibility for the homeowner's defaulted mortgage debt. The parties also entered into a contract whereby Johnson would reconvey the property to the homeowner if he was repaid for the payments he had to make to satisfy the debt, and in the interim the homeowner paid rent to Johnson. *Johnson*, 33 S.E.2d at 785. Nothing in the reconveyance contract personally obligated the homeowner to make such repayments, and the court recognized that "[i]t is essential to a mortgage that there be a debt to be secured." *Id*. at 789. Nevertheless, the court held that "[t]he facts and circumstances clearly and satisfactorily show that the deed, notwithstanding its form, was intended only as a mortgage to secure the debts of the grantor and expenditures of the grantee, and that the plaintiffs were entitled to a reconveyance of the property upon reimbursement of the trustee." *Id*. at 790.

Consistent with these cases, the United States Bankruptcy Court for the Eastern District of Virginia recently held, in the course of reviewing a modern foreclosure prevention transaction, that the necessary debt to create an equitable mortgage under Virginia law was present in a purported conditional sale that included a provision forcing the homeowner to forfeit her property if she did not repay the advance to stop her foreclosure even though the contract *explicitly* stated that *no* loan was created and did not provide for personal recourse. *See Brannan v. Brymer* (*In re Brannan*), No. 06-3125, 2008 WL 1752206, at *2 (Bankr. E.D. Va. Apr. 14, 2008). Moreover, the advance to stop the foreclosure was not paid until after the homeowner executed the deed. *Id.* at *3. The court explained that a debt transaction occurred because the homeowner "transferred title to her property . . . in order to give [the lender] security for the amounts paid to stop the [bank's] foreclosure. . . . Essentially, [homeowner] promised to pay forty percent of the equity in the residence to [the lender] in exchange for the advance of the $7,500.00 advanced to stop the [bank's] foreclosure." *Id*. at *11.[11]

The obligation to pay money to retain ownership of one's home, even though formally structured as a repurchase agreement, serving as an equitable mortgage's underlying debt is a necessary consequence of Virginia's heightened scrutiny of purported conditional sales. *See supra* pp. 22-24. Indeed, viewing the form of the transaction—a conditional sale with a right to repurchase that does not formally speak of the creation of a debt—as dispositive would create a wholesale exemption to the equitable mortgage doctrine rather than applying the required extra scrutiny. As the United States Supreme Court long ago explained in reviewing a transaction containing an agreement that "clearly intended to manifest a conditional sale":

> The [agreement] does not contain any promise by [the property owner] to repay the money, and no personal security was taken; but it is settled that this circumstance does not make the conveyance less effectual as a mortgage. And consequently it is not only entirely consistent with the conclusion that a mortgage was intended, but in a case where it was the design of one of the parties to clothe the transaction with the forms of a sale . . . it is not to be expected that the

[11] Chief Bankruptcy Judge Tice's *In re Brannan* opinion demonstrates that there is no inconsistency between his earlier articulation of Virginia's equitable mortgage doctrine in *In re Seven Springs* and the principle that the debt necessary to create an equitable mortgage exists in a transaction obligating the homeowner to reimburse the payoff of a prior mortgage loan in order to maintain home ownership, even if formally designated as a repurchase right. *See In re Brannan*, 2008 WL 1752206, at *10-12 (applying *In re Seven Springs*).

> party would, by taking personal security, effectually defeat his own attempt to avoid the appearance of a loan.

Russell, 53 U.S. (12 How.) at 151-52 (citation omitted). Consistent with Virginia's jurisprudence, the United States Supreme Court held that an agreement's repurchase provision created the necessary debt. *Id*. at 153.

The Restatement (Third) of Property (Mortgages) is also consistent with Virginia's view: the debt necessary to create an equitable mortgage can arise from the repurchase feature of a purported conditional sale without regard for a separate agreement creating personal liability. *See* Restatement, *supra*, § 3.3(a) (stating that the obligation necessary to create an equitable mortgage "need not be the personal liability of any person"). Its explanation for this position is founded on the reasoning adopted by Virginia's supreme court in *Tuggle*. In accord with *Tuggle*'s holding that an "implied" promise to pay creates the necessary debt, 43 S.E. at 201, the Restatement states that "a court may impute the existence of the debt where the totality of the facts indicate that a security transaction was intended." Restatement, *supra*, § 3.2 cmt. e. As the Restatement explains, "[t]o require not only an obligation but grantor personal liability as well would impose in the equitable mortgage context a requirement that is inapplicable to formal or 'legal' mortgages. In the latter setting, 'non-recourse' obligations are clearly mortgageable." *Id*. § 3.2 reporters note cmt. e. A leading mortgage treatise elaborates:

> [P]ersonal liability on the debt or obligation should not be required in the conditional sale setting. Since non-recourse security transactions are common and valid in formal mortgage transactions, there is no compelling reason to conclude otherwise with respect to the conditional sale and numerous courts have so indicated. Indeed, simply the expectation or assumption by the parties that repayment will occur should suffice.

Nelson & Whitman, *supra*, § 3.19, at 70 (footnotes omitted).

Likewise, other jurisdictions concur that the debt necessary to create an equitable mortgage can arise from the repurchase feature of a purported conditional sale. *See In re Cox*, 493 F.3d at 1341 ("[P]arties may create a mortgage although the instruments they use suggest that a conveyance of title rather than the creation of a lien. A lien may be created even when there is no provision for the payment of the debt."); *Rice v. Wood*, 346 S.E.2d 205, 210 (N.C. Ct. App. 1986) (implying the existence of a debt creating an equitable mortgage from a repurchase provision and rejecting the defendants' argument "that the transaction could not be a mortgage because there was no debt created by the transaction since the contract to repurchase was entirely optional with the plaintiffs as to whether they would repurchase their home"); *James v. Ragin*, 432 F. Supp. 887, 890 (W.D.N.C. 1977) (holding that a repurchase provision constituted a debt because "[f]ailure to repay would have drastic consequences to" the homeowner).

Accordingly, in line with Virginia authority, the Restatement, and the jurisprudence from other states, the provision in the Johnsons' transaction with Washington that provided that the couple could formally reacquire title to their house upon reimbursing Washington for paying off their NovaStar mortgage created a debt for purposes of the equitable mortgage doctrine. The Johnsons are in an identical factual position to the homeowners in *Snavely, Tuggle, Magee,* and *Johnson*. In exchange for signing a deed that purported to convey absolute ownership of their homes, all five sets of homeowners had outstanding debts secured by their homes paid off to strangers to the transaction, and all five sets of homeowners could formally reacquire title to their homes upon reimbursing the grantee for making that payoff. Accordingly, the Johnsons are also in an identical legal position to the homeowners who Virginia's supreme court held in that quartet of cases had an outstanding debt arising from the reacquisition provision. As Virginia's supreme court has made clear, the absence of a separate written repayment agreement between the Johnsons and Washington is of no consequence.

The district court erred by failing to recognize that, as a matter of law, the Johnsons' repurchase provision serves as the debt necessary to create an equitable mortgage. Although the district court held that no debt existed because "[t]here was no penalty if the Johnsons chose not to exercise their repurchase option," JA444, 465, the Johnsons were *obligated* to repay Washington the amount he advanced to satisfy their prior mortgage loan *if they wished to keep their home*. By adopting a constrained concept of debt unsupported by Virginia's equitable mortgage jurisprudence, the district court committed reversible legal error.

The district court's refusal to treat the repurchase provision as a debt for purposes of the equitable mortgage doctrine, contrary to the jurisprudence of Virginia's supreme court and the usual position of American jurisprudence, relied on a single written opinion that purported to interpret Virginia law. *See* JA443-44, 463-64 (citing *Clemons v. Home Savers LLC*, 530 F. Supp. 2d 803 (E.D. Va. 2008), *aff'd*, __ F. App'x ___, No. 08-1230 (4th Cir. Apr. 14, 2008) (unpublished)). This support is illusory because the *Clemons* opinion provides no support for the proposition that a debt does not arise absent personal recourse against the homeowner. *See Clemons*, 530 F. Supp. 2d at 809.

Therefore, the district court erred as a matter of law in holding that the transaction did not create a debt that could be secured by an equitable mortgage. Accordingly, the district court's ruling that an equitable mortgage was not created must be reversed.

B. The Parties' Intent Demonstrates the Transaction Created an Equitable Mortgage.

Whether a purported conditional sale created an equitable mortgage ultimately turns on an examination of the parties' intent: "The character of the transaction is fixed by the intent of the parties at the time the transaction is entered into." *Johnson*, 33 S.E.2d at 789. Thus, the delivery of a deed will be treated as an equitable mortgage that does not transfer ownership if it was intended by the parties to ensure repayment of an advance.

The circumstances surrounding the purported conditional sale are investigated to determine whether the parties intended to create a debt transaction. *See In re Seven Springs*, 159 B.R. at 756 (explaining the need to investigate "circumstantial factors" to determine whether an equitable mortgage exists); *Johnson*, 33 S.E.2d at 788 ("Whether the transaction was a conditional sale or mortgage must be determined upon a consideration of the written instruments, read in the light of the circumstances which surround the contracting parties and their disclosed intentions, acts and conduct prior to, at the time of, and subsequent to the execution thereof."). This investigation considers all the circumstances surrounding the transaction. *See Magee*, 191 S.E. at 523 ("If, *upon the whole investigation*, it shall appear that a security for money was intended, it is a mortgage, whatever may be its terms; . . . ." (emphasis added) (omission in original) (quoting 1 Minor, *supra*, § 605)); Restatement, *supra*, § 3.3(b) ("Such intent may be inferred from the totality of the circumstances . . . .").

Certain factors have been held to be particularly instructive in determining the parties' intent. Factors most regularly indentified by Virginia's supreme court as instructive are: the nature of the negotiations between the parties, *Magee*, 191 S.E. at 522 (lack of negotiation over price); *Snavely*, 70 Va. (29 Gratt.) at 36 (negotiation focused on repaying outstanding debt to third party); *Earp v. Boothe*, 65 Va. (24 Gratt.) 368, 375-76 (1874) (lack of negotiation over price); the disparity between the value of the land and the amount of money exchanged, *Magee*, 191 S.E. at 522 (grantor received 58% of market value); *Batchelder v. Randolph*, 71 S.E. 533, 534 (Va. 1911) (grantor received 53% of market value); *Tuggle*, 43 S.E. at 201 ("no price or an inadequate one" is a sign of an equitable mortgage); *Snavely*, 70 Va. (29 Gratt.) at 36-37 ("great disproportion between the value of the land and the amount of money advance" is "very potent to show that a mortgage was intended"); and the possession of the property after the transaction, *Batchelder*, 71 S.E. at 534 (mortgage found when grantor maintained possession of house after transaction); *Tuggle*, 43 S.E. at 201 (same); *Snavely*, 70 Va. (29 Gratt.) at 37, 40 (same). Other factors identified by Virginia's supreme court include: the setting of a fixed time for repayment, *Hunter*, 149 S.E. at 469 ("no definite time" for repayment found as a sign of genuine conditional sale); the existence of regular interim payments between the parties, *Snavely*, 70 Va. (29 Gratt.) at 37 ("regular payments . . . of the interest as it annually accrued" found as a sign of an equitable mortgage); and the homeowner's financial distress, *Johnson*, 33 S.E.2d at 789 (financially distressed state of homeowner found as a sign of an equitable mortgage).

Similarly, the Restatement highlights seven circumstantial factors that American courts commonly review when determining the parties' intent:

> (1) statements of the parties; (2) the presence of a substantial disparity between the value received by the grantor and the fair market value of

> the real estate at the time of the conveyance; (3) the terms on which the grantor may purchase the real estate; (4) the fact that the grantor retained possession of the real estate; (5) the fact that the grantor continued to pay real estate tax; (6) the fact that the grantor made post-conveyance improvements to the real estate; and (7) the nature of the parties and their relationship prior to and after the conveyance.

Restatement, *supra*, § 3.3(b).

The circumstances of the Johnsons' transaction evidenced by the summary judgment record satisfies numerous of the equitable mortgage factors discussed above that disclose the parties' intent to create a debt transaction:

- Robinson's status as a mortgage broker who came into contact with the Johnsons in order to help them find a loan demonstrates the borrower-lender nature of the parties' relationship prior to the conveyance and the lending nature of their negotiations, *see, e.g.*, JA248, 276, 372;
- The Johnsons' testimony that Robinson explicitly described the transaction as a "loan" and that no discussion of selling the house occurred between the couple and Robinson or Washington demonstrates the statements of the parties were consistent with a loan and the lending nature of their negotiations, *see, e.g.*, JA150, 172, 178, 233, 392-93;
- The parties' focus on forestalling NovaStar's foreclosure demonstrates the borrower-lender nature of the parties' relationship prior to the conveyance and the homeowners' financial distress, *see, e.g.*, JA107, 152, 311;

- The lack of negotiation over the purported sale price demonstrates the lending nature of the negotiations between the parties, *see, e.g.*, JA203-04;
- The significant disparity between the effective sales price and the market value of the property, causing the Johnsons to lose $91,200 in home equity, demonstrates a significant disparity between the value received and fair market value, *see supra* p. 14;
- The Johnsons' continued use of the house after the transaction, particularly in light of Washington's stated intent not to create a landlord-tenant relationship, demonstrates continued possession consistent with a loan, *see, e.g.*, JA42 ¶5.1;
- The direct relationship between the Johnsons' monthly payment obligation after the transaction and the monthly payments due on the mortgage brokered as part of the transaction demonstrates the lending nature of the negotiations and the existence of regular interim payments, *see, e.g.*, JA 40 ¶2;
- The Johnsons' contemporaneous reference to these monthly payments as mortgage payments demonstrates the borrower-lender nature of the parties' relationship after the conveyance and the statements of the parties were consistent with a loan, *see, e.g.*, JA158;

- The Johnsons' obligation to pay the insurance, taxes, and upkeep of the property after the transaction demonstrates continued payment of real estate taxes and the borrower-lender nature of the parties' relationship after the conveyance, *see, e.g.*, JA40-42 ¶¶2, 2.2, 5;
- The Johnsons' reinvestment of the proceeds they received from the transaction into home improvements demonstrates making post-conveyance improvements, *see, e.g.*, JA407;
- The requirement that the Johnsons repay Washington the fixed sum of $212,800 within a fixed, thirteen-month period demonstrates setting a fixed time for repayment, *see, e.g.*, JA40-42 ¶¶2, 8;
- The requirement that the Johnsons' repayment to Washington cover his payoff to NovaStar demonstrates the terms of the purchase were consistent with a loan, *see, e.g.*, JA40 ¶2;
- Robinson's statements—including "Washington does not want your house," "I do not want your house," and "you can refinance in twelve to thirteen months"—explaining that neither he nor Washington wished to become the owners of the house—demonstrates the statements of the parties were consistent with a loan, *see, e.g.*, JA113, 127, 196, 249; and
- The language of the "Contract for Deed of Real Property" that speaks in terms of a debt obligation and contemplates a "refinance" of the agreement

within thirteen months demonstrates the statements of the parties and the terms of purchase were consistent with a loan, *see, e.g.*, JA40-42 ¶¶1.2, 5, 8.

In summary, based on the factors Virginia courts typically examine, the facts in this case provide abundant evidence of an equitable mortgage. The negotiations began over the brokering of a loan and never discussed a sale; there was a substantial disparity between market value and benefit obtained by the Johnsons; the Johnsons retained possession of the house even after the transaction; there was a fixed time for repayment; there were regular interim payments; and the Johnsons faced financial distress. Similarly, the Restatement's enumerated factors all support an equitable mortgage in this case.

Accordingly, courts in other jurisdictions that have examined similar transactions in recent years have held they create equitable mortgages. For example, the North Carolina Court of Appeals held an equitable mortgage was created based on facts remarkably similar to the Johnsons' transaction. In that case, homeowners who had fallen behind on their mortgage payments were approached by a real estate agent who "offered his help" to resolve their financial difficulties:

> [The agent] then arranged what the [homeowners] testified they understood to be a second mortgage on their home. Both [homeowners] testified that they requested a loan from [the real estate agent], that they explained they wanted a second mortgage and wanted to keep their home. They testified that at no time did they ever intend to sell their home, but they admitted to signing all of the relevant documents. They did not read all of the

> documents that they signed though no one prevented them from reading the documents. They further testified that no one read or explained the documents to them and that at all times they believed they were signing documents to obtain a second mortgage on their home.

Rice, 346 S.E.2d at 205.[12]

In fact, the homeowners had signed a contract authorizing the agent to list their house at a substantial discount to its true market value. The agent had the homeowners contact a pair of "investors," and the homeowners subsequently signed an "Offer to Purchase and Contract" that purportedly sold the house for an amount that covered the unpaid mortgage balance plus gave the homeowners a nominal amount of cash. *Id*. at 206-07. Along with that contract, the homeowners signed an agreement allowing them to "repurchase" their house from the investors within eighteen months for an amount that represented the investors' outlay plus a profit and providing that they would make regular monthly payments, which would cover the investors' mortgage payments during the course of the eighteen months. *Id*. at 207.

The defendants claimed that the evidence entitled them to judgment as a matter of law. "[L]ook[ing] at the circumstances to be considered in determining

[12] In contrast, the real estate agent "testified that he informed the [homeowners] that he could not make them a loan" and that "he explained the conditional sale to the [homeowners] and that they had no objections or questions." *Rice*, 346 S.E.2d at 207. And the investors "testified that they never intended to make any loan" to the homeowners and instead "entered into the arrangement as a business investment . . . solely for the purpose of buying the . . . home as investment property." *Id*. at 207-08.

actual intent"—just as Virginia's equitable mortgage doctrine dictates—the court held that "we find here ample facts and circumstances sufficiently proved to support [the homeowners'] claim." *Id*. at 209. Four factors were particularly instructive: the homeowners' retention of possession in exchange for rent based on the investors' monthly mortgage payment; the sale price well below market value and based upon the amount of the mortgage; the fact that the transaction "began out of negotiations for a loan not a sale"; and the financial distress of the homeowners at the time of the transaction. *Id*.

Other jurisdictions have similarly concluded that facts similar to those of the Johnsons' transaction created an equitable mortgage:

- A Minnesota federal district court last year held that an "investor" was not entitled to summary judgment on an equitable mortgage claim involving a homeowner facing foreclosure who held a repurchase right pursuant to a "contract for deed" and purportedly sold his house for $64,000 below market value without negotiating the price or advertising it on the open market. *Jones v. Rees-Max, LLC*, 514 F. Supp. 2d 1139, 1145-46 (D. Minn. 2007).
- A North Carolina federal district court held a transaction created an equitable mortgage when the homeowners had unsuccessfully sought out conventional loans from a number of sources, contacted a real estate agent "for the purpose of borrowing the necessary amount," and signed an

agreement prepared by the agent that purported to sell the house and then allow the homeowner formally to repurchase it. *James*, 432 F. Supp. at 890-91.

- The Oregon Court of Appeals held a transaction created an equitable mortgage when a financially distressed homeowner deeded her house without bargaining over price for an amount well below fair market value to the branch manager of a finance company who paid off her defaulted mortgage loan and two weeks later had her sign an agreement providing a right to reacquire the property. *Long v. Storms*, 622 P.2d 731, 739 (Or. Ct. App. 1981).
- The Michigan Court of Appeals held an equitable mortgage existed in a transaction in which the deed grantee who paid off a defaulted mortgage debt told the "financially distressed" homeowner that "You don't have to lose your house, I save a lot of houses" and included an agreement in which the grantor would make monthly payments for two years with the right formally to repurchase the property. *Grant v. Van Reken*, 246 N.W.2d 348, 349, 351 (Mich. Ct. App. 1976).

The summary judgment record both satisfied numerous factors that Virginia courts have examined to determine the parties' intent to create a lending transaction and mirrored facts held to create equitable mortgages by numerous other jurisdictions. The district court, however, failed to review this evidence of the transaction's circumstances. Instead, it deemed that examination irrelevant after making the erroneous legal conclusion that the requisite debt did not exist. *See* JA442, 444, 463, 465. But summary judgment was not appropriate: When the correct legal standard on both the debt and intent elements is applied, the circumstances of this transaction support the creation of an equitable mortgage.[13]

III. THE DEFENDANTS VIOLATED VARIOUS BORROWER PROTECTION STATUTES IF AN EQUITABLE MORTGAGE EXISTS.

As explained at the outset, the equitable mortgage doctrine prevents lenders from subverting borrower protection law by clothing loans in the form of conveyances. Accordingly, lenders and mortgage brokers are required to comply with borrower protection laws, including TILA and MLBA, in transactions that create equitable mortgages. The district court's determination that the defendants did not violate these laws must be reversed because, as demonstrated above, the district court erred in granting summary judgment to the defendants on the Johnsons' equitable mortgage claim.

[13] Although the plaintiffs maintain that Virginia law clearly precludes summary judgment in favor of the defendants on the question of whether this transaction created an equitable mortgage, they suggest certification of this question to the Virginia Supreme Court if this Court determines Virginia law is uncertain.

A. Liability Under the Truth in Lending Act.

TILA requires a creditor to make certain disclosures as part of a consumer credit transaction. *See* 15 U.S.C. § 1631(a). If a transaction created an equitable mortgage, the nominal buyer in the purported conditional sale transaction is a TILA creditor. *See Redic*, 762 F.2d at 1184-85;[14] *Jones*, 514 F. Supp. 2d at 1145. Accordingly, the district court correctly held that TILA would apply to the Johnsons' transaction if it created an equitable mortgage. *See* JA462.

Because the Johnsons did not receive any of the disclosures required by TILA, their March 8, 2007 request to rescind the loan was timely, coming within three years of the transaction date. *See* 15 U.S.C. § 1635(a), (f). If the Johnsons prevail on their equitable mortgage claim, they have a right to recover the equity stripped from them by rescinding the transaction, subject to the district court's procedural supervision. *See Am. Mortgage Network v. Shelton*, 486 F.3d 815, 820

[14] Although at the time of *Redic* TILA only applied to creditors who entered into more than five transactions secured by a dwelling, 762 F.2d at 1185 (citing 12 C.F.R. § 226.2(a)(17)(i)n.3 (1984)), it was subsequently amended by the Home Ownership and Equity Protection Act ("HOEPA") to reduce that requirement for high-cost loans, *see* Pub. L. No. 103-325, 108 Stat. 2190 (1994). Since the enactment of HOEPA, "any person who originates 1 or more [high-cost] mortgages through a mortgage broker shall be considered to be a creditor." 15 U.S.C. § 1602(f). Refinancing a principal dwelling at an annual percentage rate of interest more than ten points above the yield on comparable United States Treasury securities creates a high-cost mortgage. 15 U.S.C. § 1602(aa)(1). The 28% APR of Washington's loan, *see supra* p. 13, is twenty-five points higher than the relevant Treasury interest rate. Accordingly, Washington was a creditor for purposes of TILA because this equitable mortgage was arranged by a mortgage broker.

(4th Cir. 2007) ("The equitable goal of rescission under TILA is to restore the parties to the 'status quo ante.'"). Moreover, the Johnsons have a right to use a TILA violation as a "defense by recoupment or set-off" against Washington's attempt to collect on the transaction. 15 U.S.C. § 1640(e). Accordingly, the erroneous grant of summary judgment on the equitable mortgage claim requires reinstating the Johnsons' TILA claims against Washington and vacating judgment on Washington's breach of contract counterclaim.

B. Liability Under the Virginia Mortgage Lender and Broker Act.

Under MLBA, a "mortgage broker" is "any person who directly or indirectly negotiates, places or finds mortgage loans for others, or offers to negotiate, place or find mortgage loans for others." Va. Code Ann. § 6.1-409.[15] In turn, a "mortgage loan" is defined under MLBA as a loan "*secured by a mortgage* or deed of trust upon any interest in one- to four-family residential owner-occupied property located in the Commonwealth." *Id*. (emphasis added). Accordingly, the district court correctly held that MLBA "applies if the transaction qualifies as a mortgage loan" under the equitable mortgage doctrine. JA442.

As codified in Virginia Code § 6.1-422, MLBA prohibits certain predatory lending practices, including "receiv[ing] compensation from a borrower until a

[15] For purposes of MLBA, a "person" is defined as "any individual, firm, corporation, partnership, association, trust, or legal or commercial entity or group of individuals however organized." Va. Code Ann. § 6.1-409.

written commitment to make a mortgage loan is given to the borrower by a mortgage lender." Va. Code Ann. § 6.1-422(B)(1). The Johnsons never received such written commitment from Robinson or D&D. Moreover, Robinson and D&D received significant compensation from the transaction with the Johnsons, which was included in the amount the Johnsons were obligated to repay Washington. JA46 lines 803-806. Robinson and D&D thus committed a prohibited predatory lending practice once the Johnsons' transaction is properly characterized as a loan.

MLBA provides that "[t]he Attorney General, the [State Corporation] Commission, *or any party to a mortgage loan* may enforce the provisions of . . . § 6.1-422." Va. Code Ann. § 6.1-422.1(C) (emphasis added). The district court correctly determined that this provision allows the Johnsons to seek damages for violations of the provisions in § 6.1-422. JA76; *see also Clemens v. Home Savers, LLC*, No. 07-244, 2007 WL 2815213, at *4 n.3 (E.D. Va. Sept. 21, 2007) (holding § 6.1-422.1(C) creates a private right of action for alleged violations of § 6.1-422).[16] Therefore, the erroneous grant of summary judgment on the equitable mortgage claim also requires reinstating the Johnsons' MLBA claim against Robinson and D&D.

[16] Although *Stith v. Thorne* states that MLBA does not allow for a private cause of action, it fails to address the clear language of § 6.1-422.1(C) authorizing such actions for the portion of MLBA that prohibits enumerated predatory lending practices. *See* 247 F.R.D. 89, 96 (E.D. Va. 2007).

IV. DEFENDANTS COMMITTED FRAUD IF THE TRANSACTION DID NOT CREATE AN EQUITABLE MORTGAGE.

If this Court concludes that the Johnsons' transaction did not create an equitable mortgage, the district court erred in granting summary judgment on the Johnsons' fraud claims against Robinson and D&D. The district court concluded that Robinson and D&D were entitled to summary judgment on the fraud claim on two bases: (1) that no misrepresentations of fact occurred and (2) that the Johnsons' failure to read the transaction's documents barred the claim. JA439.

The district court's summary judgment analysis both misapplied Virginia law as to whether a misrepresentation occurred and failed to consider long-standing Virginia law that prevents Robinson and D&D from repeatedly falsely representing that the contract was a mortgage to the Johnsons and then hiding behind the defense that the Johnsons failed to read the contract.

A. Misrepresentations of Fact Occurred.

The district court erred in determining that no misrepresentations of facts occurred and thus summary judgment was inappropriate on the Johnsons' fraud claim.

It is black letter law that a misrepresentation of a fact must serve as the foundational underpinning of a fraud claim. *See, e.g.*, *Winn v. Aleda Constr. Co.*, 315 S.E.2d 193, 195 (Va. 1984). The misrepresentation that serves as the basis for a fraud claim must be "of an existing fact and not the mere expression of an opinion." *Tate v. Colony House Builders, Inc.*, 508 S.E.2d 597, 599 (Va. 1999). However, Virginia law is clear that *statements of intent are facts and not opinions*. *Lloyd v. Smith*, 142 S.E. 363, 366 (Va. 1928).[17] Thus, it is clear that if one "represents his state of mind—that it, his intention—as being one thing when in fact is just the contrary, he misrepresents a then existing fact." *Id*.

The very two sets of statements examined in the district court's summary judgment analysis, JA437-38, demonstrate that Robinson and D&D misrepresented to the Johnsons facts relating to their intent as to the very nature of the transaction. The statements "I do not want your house" and "Jason Washington does not want your house" are misrepresentations of their intent "as being one thing when in fact is just the contrary" and thus misrepresentations of then-existing facts. *See Lloyd*, 142 S.E. at 366. As pointed out by Vivian Johnson herself in her deposition, the defendants could not both intend to create a transaction in which the Johnsons sell their house and not "want" their house; not "want[ing]" the Johnsons' house is only consistent with intent to lend money to the Johnsons.[18] Virginia law makes clear that the defendants' statements of intent are facts and not opinions: Thus, the

[17] The district court cited this very case but failed to apply its analysis. JA437.
[18] "I'm telling you what [Robinson] said, sir, he did not want my house, and Mr. Washington did not want my house. If—you know why we're sitting here. It's because my house is in limbo now. Why can't I say I'm the owner of the house? It's because I was told a bunch of lies. Somebody wanted my house. I can't even say I'm the owner of my house. I have no reason to lie. He did not keep his word. If he didn't want my house and Mr. Washington didn't want my house, why are we here?" JA128, 388.

district court's conclusion that those statements are mere "opinions and expressions of desire" rather than the fact of their intent runs contrary to well established Virginia law. Moreover, Robinson's and D&D's defenses to the equitable mortgage claim and the fraud claim based on these statements are irreconcilable. As to the equitable mortgage claim, they could not intend to create a loan transaction. As to the fraud claim, they could not intend to create a sales transaction whereby the Johnsons would lose ownership of their house.

The other statement the district court examined is an absolutely false statement of fact. The statement "you can refinance in twelve to thirteen months"—contrary to the court's analysis—is unquestionably false: one cannot "refinance" a loan on a property that one does not own. *See* 12 C.F.R. § 226.20(a) ("A refinancing occurs when an existing obligation that was subject to this subpart is satisfied and replaced with a new obligation undertaken by the same consumer."). Here, the district court found the agreement was an absolute sale of the Johnsons' home to Washington. But if the district court was correct, the Johnsons would have had to obtain a purchase money mortgage to repurchase their home, rather than refinance, because one must own a home to refinance it. Again, the defendants' statement is true only if the transaction created an equitable mortgage.

Accordingly, summary judgment on the Johnsons' fraud claim should be reversed because the district court misapplied the concept of misrepresentation.

B. Failure To Read a Contract Does Not Necessarily Bar a Fraud Claim.

The Johnsons admitted that they did not read the transaction's documents prior to signing them. The district court held that failure was an absolute bar to the Johnsons' fraud claims. However, a failure to read a contract is not an absolute bar to a fraud claim arising under Virginia law from that contract. Moreover, Virginia courts have recognized that fraudulent misrepresentations made to induce persons to enter into contracts can serve as the basis for actionable fraud claims even when the express terms of the contract contradict those representations.[19]

"Ordinarily, one who signs a contract cannot avoid it on the ground that he did not read it or that he took someone else's word as to what it contained." *Chandler v. Aero Mayflower Transit Co*., 374 F.2d 129, 136 (4th Cir. 1967). The next sentence of that very case cited by the district court, however, states an exception to the rule: "But an agreement signed without negligence under the belief that it is an instrument of a different character is void, and the failure to read

[19] Even if the Johnsons had read the contract, the meaning of that contract—whether it created a sale or an equitable mortgage—has been at issue in this litigation and debated by courts and scholars and thus would most certainly be unclear to two laypeople.

an instrument is not negligence per se but must be considered *in light of all surrounding facts and circumstances*." *Id*. (emphasis altered).

Moreover, longstanding Virginia law recognizes fraud as another exception to blind deference to the terms of a contract: "[T]he cases are clear that, in Virginia, one cannot, by fraud and deceit, induce another to enter into a contract to his disadvantage, then escape liability by saying that the party to whom the misrepresentation was made was negligent in failing to learn the truth." *Nationwide Ins. Co. v. Patterson*, 331 S.E.2d 490, 492 (Va. 1985). That principle remains true even when the misrepresentations made to induce the contract are expressly contradicted in the contract. *See id*. (allowing recovery for fraud when terms of insurance contract contradicted representation of agent).

Here, the district court failed to consider the facts and circumstances surrounding the Johnsons' failure to read the instrument. The record shows that the circumstances here were far from that of a normal home sale: Robinson was a mortgage broker—not a real estate agent; Robinson continually invoked the Johnsons' shared religious faith as the reason he was helping them; Robinson and his wife repeatedly consoled Vivian Johnson as she cried; and Robinson continually misrepresented the nature of the transaction as helping them refinance rather than sell their home. *See* JA409-10.

Furthermore, the district court's analysis failed to consider Virginia's unwillingness to allow those who make misrepresentations about the terms of a contract to deny liability based on the language of the very same contract. Robinson and D&D continually and repeatedly represented to the Johnsons that they were helping them to obtain a loan to refinance their home—not selling it. Indeed, the subject of a selling the home "never came up" according to Vivian Johnson. JA150. Here, allowing Robinson and D&D to avoid fraud liability because their lies to the Johnsons were contradicted by terms in a contract would be the exact kind of "fraud and deceit" that Virginia courts do not tolerate.

Thus, summary judgment in favor of the defendants on the fraud claim was inappropriate when the record contained evidence about the transaction's unusual circumstances and the defendants misrepresented the very contract they seek to hide behind.

CONCLUSION

The district court erred in its legal interpretation of Virginia's equitable mortgage doctrine and consequently misapplied the doctrine to the Johnsons' transaction. Moreover, its conclusion that the transaction did not create an equitable mortgage is inconsistent with its conclusion that the transaction did not involve fraud. Accordingly, the district court's grant of summary judgment for defendants on the Johnsons' claims and on Washington's counterclaim must be reversed.

REQUEST FOR ORAL ARGUMENT

Plaintiffs respectfully request oral argument. Plaintiffs believe that oral argument will be beneficial to the Court because of the scarcity of recent Virginia case law examining the equitable mortgage doctrine and its importance given the recent increase in foreclosure rates and corresponding foreclosure prevention transactions.

Respectfully submitted,

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CERIFICATE OF COMPLIANCE

1. This brief complies with the type-volume limitation of Fed. R. App. P. 32(a)(7)(B) because this brief contains 12,537 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

2. This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirement of Fed. R. App. P. 32(a)(6) because this brief has been prepared in a proportionally spaces typeface using Microsoft Office Word 2003 in 14-point Times New Roman.

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CERTIFICATE OF SERVICE

I hereby certify that on this 27th day of May 2008, I served two copies of the foregoing Brief for Appellants Marion D. Johnson and Vivian Y. Johnson via UPS, postage prepaid, on each party herein through their counsel at the following addresses:

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