Filed 10/11/12 Thibault v. American Mortgage Network CA6

NOT TO BE PUBLISHED IN OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

SIXTH APPELLATE DISTRICT

JOHN THIBAULT et al., Plaintiffs and Appellants, v. AMERICAN MORTGAGE NETWORK, INC., et al., Defendants and Respondents.	H036620 (Santa Clara County Super. Ct. No. 1-09-CV158417)

This is one of a number of cases filed in California state and federal courts raising the issue whether borrowers who entered into option adjustable rate mortgages (Option ARM's) can state viable causes of action for (1) fraud (based on fraudulent omissions) or (2) violation of the unfair competition law (UCL) (Bus. & Prof. Code, § 17200 et seq.)[1] on the theory that their loan documents failed to disclose the essential terms of their loans, namely that their loans were guaranteed to cause negative amortization if the borrowers made payments according to the only payment schedule the lenders gave them before the loans closed. Negative amortization is an increase in a loan's principal balance that occurs when the monthly payments are insufficient to pay accruing interest. (See Black's Law Dict. (8th ed. 2004) p. 93, col.2.)

[1] All further statutory references are to the Business and Professions Code unless otherwise stated.

In this case, John Thibault, Juan Torres Perez, and Andrea Krumme (hereafter jointly Plaintiffs)[2] sued American Mortgage Network, Inc. and Amnet Mortgage, Inc. (hereafter jointly Amnet), Countrywide Home Loans, Inc. and Countrywide Financial Corporation (hereafter we shall refer to the Countrywide defendants jointly as "Countrywide" and to all defendants jointly as "Defendants") for alleged fraudulent omissions and violations of section 17200 et seq. Plaintiffs are individual borrowers who obtained Option ARM's from Defendants in 2005 and 2006. They allege that Defendants' loan documents failed to disclose the certainty of negative amortization if they made monthly payments according to the only payment schedule provided to them prior to the closing of their loans, and that the documents failed to disclose other important material facts. The trial court sustained Defendants' demurrers to Plaintiffs' first amended complaint without leave to amend. The court reasoned that there were no fraudulent omissions or concealments because the loans "do not necessarily cause negative amortization as they clearly disclose that it will occur only if the minimum payment is not sufficient to cover the amount of interest due and [Plaintiffs] *chose* to not pay more than the minimum payment." The court reasoned that Defendants' actions were not fraudulent or unlawful under the UCL for the same reasons and that the loans were not "unfair" under the UCL because "Plaintiffs could have reasonably avoided their claimed injuries by making more than only the minimum payments under the loan agreements."

In August 2011, after the trial court sustained the demurrers in this case without leave to amend and after Plaintiffs filed their opening brief on appeal, the California Court of Appeal, Fourth Appellate District, Division Three, addressed the issue presented

---

[2] Krumme's loan documents were also signed by James Krumme and Thibault's loan documents were also signed by Algeline Thibault. James Krumme and Algeline Thibault are not parties to the lawsuit.

in this case in *Boschma v. Home Loan Center, Inc*. (2011) 198 Cal.App.4th 230 (*Boschma*). The *Boschma* court concluded that the plaintiffs in that case, borrowers who had obtained Option ARM loans from Home Loan Center that are similar to those at issue in this case, could state causes of action for fraudulent omissions and violations of the UCL against their lender.[3] Like the plaintiffs in this case, the plaintiffs in *Boschma* had alleged that their lender's loan documents failed to adequately and accurately disclose the certainty of negative amortization if they made monthly payments according to the only payment schedule provided to them prior to the closing of the loan. (*Boschma*, *supra*, at pp. 234-235.) The trial court in *Boschma* had sustained the lender's demurrer to the second amended complaint without leave to amend, reasoning, as the trial court did here, that the loan documents adequately describe the nature of the Option ARM's. The appellate court disagreed; it held that the plaintiffs had adequately alleged fraud and section 17200 causes of action and reversed the judgment. (*Id.* at pp. 234, 254.) The *Boschma* court explained that the "defining feature" of an Option ARM is that

[3] As we shall explain, a number of federal district courts have addressed this question, with mixed results. At the hearing on the Defendants' demurrers to the original complaint, counsel for Countrywide Home Loans told the court that this was one of 40 cases that alleged fraudulent concealment and violations of the UCL arising out of loan transactions involving Option ARM's, that most of the cases had been filed in federal court, and that he represented Countrywide in nine such cases.

We note that Plaintiffs' counsel represented the plaintiffs in *Boschma* and the plaintiffs in several of the federal district court cases cited by the parties in this appeal. (*Boschma*, *supra*, 198 Cal.App.4th at p. 234; see e.g. *Romero v. Countrywide Bank, N.A.* (N.D.Cal. 2010) 740 F.Sup.2d 1129; *Amparan v. Plaza Home Mortgage, Inc*. (N.D.Cal. 2010) 2010 WL 3743953; *Ralston v. Mortgage Investors Group, Inc.* (N.D.Cal., Aug. 12, 2010, No. C 08-536 JF (PVT)) 2010 WL 3211931; *Brooks v. ComUnity Lending, Inc*. (N.D.Cal. 2010) 2010 WL 2680265 (*Brooks*); *Conder v. Home Savings of America* (C.D.Cal. 2010) 680 F.Supp.2d 1168, 1171 (*Conder*) ["This case, like many others before this Court, involves" an Option ARM];*Velazquez v. GMAC Mortg. Corp*. (C.D.Cal. 2008) 605 F.Supp.2d 1049 (*Velazquez*); *Plascencia v. Lending 1st Mortg.* (N.D.Cal. 2008) 583 F.Supp.2d 1090.)

for a limited number of years at the beginning of the loan, the borrower may avoid defaulting on the loan by making a minimum monthly payment that is lower than the amount of the interest actually accruing on the loan. (*Id. at p.* 234.) Since the minimum payment is insufficient to cover the interest due, the difference between the amount of interest owed and the amount of the payment is added to the loan's principal, thereby increasing the amount borrowed. Thus, after an initial period of years (five years for the borrowers in both *Boschma* and this case), "a borrower who elects to make only the scheduled payment[s] . . . owes more to the lender than he or she did on the date the loan was made." (*Ibid.*) After this initial period in which negative amortization can occur, the borrower's payment schedule recasts to require minimum monthly payments that amortize the loan. (*Ibid.*)

As the court did in *Boschma*, we conclude that Plaintiffs have alleged sufficient facts to state causes of action for fraud and violations of section 17200 et seq. and we will therefore reverse the judgment.

FACTS

Since this appeal is from a judgment of dismissal upon an order sustaining a demurrer without leave to amend, our summary of the facts is drawn from the properly pleaded factual allegations of the complaint and those matters properly subject to judicial notice. (*Schifando v. City of Los Angeles* (2003) 31 Cal.4th 1074, 1081 (*Schifando*).)

In June 2005, Perez obtained an Option ARM for $576,000 from Countrywide. The loan was secured by Perez's residence on Rock River Court in San Jose, Santa Clara County, California.

In November 2005, Krumme obtained an Option ARM for $250,400 from Amnet. Krumme used the loan to refinance an existing loan on her primary residence on Sycamore Street in Hesperia, San Bernardino County, California. After Krumme's loan closed, it was sold to Countrywide.

In March 2006, Thibault obtained an Option ARM for $542,000 from Countrywide doing business as America's Wholesale Lender. The loan was secured by Thibault's residence on Begonia Place in Manteca, San Joaquin County, California.

The operative pleading, Plaintiffs' first amended complaint, does not specify whether Thibault's or Perez's loans were purchase money loans or were used to refinance existing loans.

Plaintiffs attached copies of certain loan documents to their first amended complaint, including: (1) the Notes documenting the terms of the mortgages, (2) program disclosure forms describing the features of the loans, and (3) Truth-in-Lending Disclosure Statements (TILDS) provided by the lenders. We shall set forth the key provisions of these documents before describing Plaintiffs' allegations. (*Barnett v. Fireman's Fund Ins. Co*. (2001) 90 Cal.App.4th 500, 505 ["we rely on and accept as true the contents of the exhibits and treat as surplusage the pleader's allegations as to the legal effect of the exhibits"].)[4]

---

[4] In support of its demurrer to the first amended complaint, Countrywide asked the trial court to judicially notice loan documents that both were and were not attached to the first amended complaint. The loan documents that were not attached to the first amended complaint included Plaintiffs' deeds of trust and adjustable rate riders. The trial court granted the request for judicial notice. Plaintiffs do not challenge the order granting the request for judicial notice.

On appeal, we are required to take judicial notice of any matter that was properly noticed by the trial court. (Evid. Code, § 459, subd. (a).) We also have the discretion to take judicial notice of matter that was subject to discretionary notice by the trial court. (*Ibid.*) We conclude that the trial court properly noticed the deeds of trust, which had been recorded, (*Evans v. California Trailer Court, Inc*. (1994) 28 Cal.App.4th 540, 549 ["court may take judicial notice of recorded deeds"]) and the adjustable rate riders (*Performance Plastering v. Richmond American Homes of California, Inc*. (2007) 153 Cal.App.4th 659, 666, fn.2 [we may take judicial notice of an agreement where "there is and can be no factual dispute" regarding the contents of the agreement].) But since these documents do not contain terms that conflict with the Note or the other loan documents, we shall not discuss the contents of these documents in any detail.

The Notes

Plaintiffs executed nearly identical documents entitled "ADJUSTABLE RATE NOTE" (Note). Each Note features a disclaimer below its title and the loan identification numbers, which states in bold, all caps lettering: "**THIS NOTE CONTAINS PROVISIONS THAT WILL CHANGE THE INTEREST RATE AND THE MONTHLY PAYMENT. THERE MAY BE A LIMIT ON THE AMOUNT THAT THE MONTHLY PAYMENT CAN INCREASE OR DECREASE. THE PRINCIPAL AMOUNT TO REPAY COULD BE GREATER THAN THE AMOUNT ORIGINALLY BORROWED, BUT NOT MORE THAN THE MAXIMUM LIMIT STATED IN THIS NOTE.**"

Following this disclaimer, each Note indicates: (1) the date of execution; (2) the city where it was executed; and (3) the address of the property that secured the loan. Each loan was for a 30-year term.

Each Note contains 11 paragraphs that set forth the terms of the loan, which we quote in relevant part below. Since the Notes are similar to one another, we shall quote the language from Perez's Note, using italics to inform the reader concerning any language that varies from Note to Note, and we will then describe any variations in the Krumme and Thibault Notes. Where two or all three of the Notes contain identical language, we shall inform the reader of that fact. And we shall follow these conventions when describing the other loan documents.

Paragraph 1 of Perez's Note provided: "**BORROWER'S PROMISE TO PAY** [¶] In return for a loan that I have received, I promise to pay U.S. $*576,000.00* (this amount is called 'Principal'), plus interest, to the order of Lender. The Principal amount may increase as provided under the terms of this Note but will never exceed 115 percent of the Principal amount I originally borrowed. This is called the 'Maximum Limit.' Lender is *COUNTRYWIDE HOME LOANS, INC*. [¶] . . . [¶] I understand that Lender may transfer this Note. Lender or anyone who takes this Note by transfer … is called the

'Note Holder.' " (Italics added.) Krumme promised to pay $250,400 and her Note stated that the Lender was American Mortgage Network, Inc. Thibault promised to pay $542,000 and his lender was Countrywide, dba America's Wholesale Lender.

Paragraph 2 of Perez's Note provided: "**INTEREST** [¶] **(A) Interest Rate** [¶] Interest will be charged on unpaid Principal until the full amount of Principal has been paid. I will pay interest at a yearly rate of *1.000* %. The interest rate I will pay may change. [¶] [¶] **(B) Interest Rate Change Dates** [¶] The interest rate I will pay may change on the *first day of SEPTEMBER, 2005*, and on that day every month thereafter. Each date on which my interest rate could change is called an 'Interest Rate Change Date.' The new rate of interest will become effective on each Interest Rate Change Date. The interest rate may change monthly, but the monthly payment is recalculated in accordance with Section 3. [¶] **(C) Index** [¶] Beginning with the first Interest Rate Change Date, my adjustable interest rate will be based on an Index. *The 'Index' is the 'Twelve-Month Average' of the annual yields on actively traded United States Treasury Securities adjusted to a constant maturity of one year* . . . . The most recent Index figure available as of the date 15 days before each Interest Rate Change Date is called the 'Current Index'. [¶] . . . [¶] **(D) Calculation of Interest Rate Changes** [¶] Before each Interest Rate Change Date, the Note Holder will calculate my new interest rate by adding [¶] *TWO & 525/1000* percentage point(s) *2.525* ('Margin') to the Current Index. The Note Holder will then round the result of this addition to the nearest one-eighth of one percentage point (0.125%). This rounded amount will be my new interest rate until the next Interest Rate Change Date. My interest will never be greater than 9.950%. Beginning with the first Interest Rate Change Date, my interest rate will never be lower than the Margin." (Italics added.)

The interest rate in paragraph 2(A) of Krumme's Note and Thibault's Note was 1.5 percent. The first Interest Rate Change Date for Krumme was January 1, 2006, and her "Margin" was 3.450 percent. The first Interest Rate Change Date for Thibault was

May 1, 2006, and his "Margin" was 4.025 percent. Although Krumme's Note used the same index as Perez's Note, Thibault's Note used a different index: "the monthly weighted average cost of savings, borrowings and advances of members of the Federal Home Loan Bank of San Francisco." Thibault's Note also provided for the payment of "Per Diem" interest at the rate of 7.375 percent "[u]p until the first day of the calendar month that immediately precedes the first monthly payment due date" of his Note. This language is not in the other two Notes.

Paragraph 3, subparts A through C, of Perez's Note provided: "**PAYMENTS** [¶] **(A) Time and Place of Payments** [¶] I will make a payment every month. [¶] I will make my monthly payments on the first day of each month beginning on *SEPTEMBER 1, 2005*. I will make these payments every month until I have paid all the Principal and interest and any other charges described below that I may owe under this Note. . . . [¶] . . . [¶] **(B) Amount of My Initial Monthly Payments** [¶] Each of my initial monthly payments until the first Payment Change Date will be in the amount of U.S. $*1,852.64* . . . . [¶] **(C) Payment Change Dates** [¶] My monthly payment may change as required by Section 3(D) below beginning on the first day of *SEPTEMBER, 2006*, and on that day every 12th month thereafter. Each of these dates is called a 'Payment Change Date.' My monthly payment also will change at any time Section 3(F) or 3(G) below requires me to pay a different monthly payment. The 'Minimum Payment' is the minimum amount Note Holder will accept for my monthly payment which is determined at the last Payment Change Date or as provided in Section 3(F) or 3(G) below. If the Minimum Payment is not sufficient to cover the amount of the interest due then negative amortization will occur. [¶] I will pay the amount of my new Minimum Payment each month beginning on each Payment Change Date or as provided in Section 3(F) or 3(G) below." (Italics added.)

Paragraph 3 of Krumme's and Thibault's Notes contained the same provisions, except Krumme's first payment was due on January 1, 2006, the amount of her initial monthly payment was $864.19, and her first Payment Change Date was January 1, 2007. Thibault's first payment was due on May 1, 2006, the amount of his initial monthly payment was $1,870.55, and his first Payment Change Date was May 1, 2007.

Paragraph 3(D) of all three Notes provided: "**Calculation of Monthly Payment Changes** [¶] At least 30 days before each Payment Change Date, the Note Holder will calculate the amount of the monthly payment that would be sufficient to repay the unpaid Principal that I am expected to owe at the Payment Change Date in full on the maturity date in substantially equal payments at the interest rate effective during the month preceding the Payment Change Date. The result of this calculation is called the 'Full Payment.' Unless Section 3(F) or 3(G) apply, the amount of my new monthly payment effective on a Payment Change Date, will not increase by more than 7.5% of my prior monthly payment. This 7.5% limitation is called the 'Payment Cap.' . . . The Note Holder will apply the Payment Cap by taking the amount of my Minimum Payment due the month preceding the Payment Change Date and multiplying it by the number 1.075. The result of this calculation is called the 'Limited Payment.' Unless Section 3(F) or 3(G) below requires me to pay a different amount, my new Minimum Payment will be the lesser of the Limited Payment and the Full Payment." Paragraph 3(D) of Perez's and Krumme's Notes ended with the following sentence, which is not in Thibault's Note: "I also have the option to pay the Full Payment for my monthly payment."

Paragraph 3(E) of all three Notes provides: "**Additions to My Unpaid Principal** [¶] Since my monthly payment amount changes less frequently than the interest rate, and since the monthly payment is subject to the payment limitations described in Section 3(D), my Minimum Payment could be less than or greater than the amount of the interest portion of the monthly payment that would be sufficient to repay the unpaid Principal I owe . . . . For each month that my monthly payment is less than the interest portion, the Note Holder will subtract the amount of my monthly payment from the amount of the interest portion and will add the difference to my unpaid Principal, and interest will accrue on the amount of this difference at the interest rate required by Section 2. For each month that the monthly payment is greater than the interest portion, the Note Holder will apply the payment as provided in Section 3(A)."

Paragraph 3(F) of Perez's and Krumme's Notes provided: "**Limit on My Unpaid Principal; Increased Monthly Payment** [¶] My unpaid Principal can never exceed the Maximum Limit equal to ONE HUNDRED FIFTEEN percent (115%) of the Principal amount I originally borrowed. My unpaid Principal could exceed that Maximum Limit due to Minimum Payments and interest rate increases. In that event, on the date that . . . paying my monthly payment would cause me to exceed that limit, I will instead pay a new monthly payment. This means that my monthly payment may change more frequently than annually and such payment changes will not be limited by the 7.5% Payment Cap. The new Minimum Payment will be in an amount that would be sufficient to repay my then unpaid Principal in full on the Maturity Date in substantially equal payments at the current interest rate." Thibault's Note contained a similar provision, with minor changes in language.

Paragraph 3(G) of Perez's and Krumme's Notes provided: "**Required Full Payment** [¶] On the *fifth* Payment Change Date and on each succeeding fifth Payment Change Date thereafter, I will begin paying the Full Payment as my Minimum Payment until my monthly payment changes again. I also will begin paying the Full Payment as my Minimum Payment on the final Payment Change Date." (Italics added.) Thibault's Note provided that Full Payments would begin on the "tenth" payment change date. This provision is inconsistent with the payment schedule in Thibault's TILDS, which provides for "Full Payments" beginning with the fifth payment change date.[5]

[5] The fact that the word "tenth" was typed rather than preprinted, suggests that the Note's reference to the "tenth" payment change date may have been a typographical error.

Each Note contained a paragraph 5, which provided that the borrower "may make . . . Prepayments without paying any Prepayment charge." But Perez's and Krumme's Notes contained prepayment penalty riders that replaced paragraph 5 of their Notes. The "PREPAYMENT PENALTY ADDENDUM" in Perez's Note provided: "I have the right to make payments of Principal at any time before they are due. . . . [¶] Subject to the Prepayment Penalty specified below, I may make a Full Prepayment or Partial Prepayments of my obligation. The Note Holder will use all of my prepayments to reduce the amount of Principal that I owe under the Note. If I make a Partial Prepayment, there will be no changes in the due date or in the amount of my monthly payment. [¶] If within the first TWELVE months after the execution of this Note, I make prepayment(s), the total of which exceeds twenty (20) percent of the original Principal amount of this Note, I agree to pay a Prepayment Penalty in an amount equal to the payment of six (6) months' advance interest on the amount by which the total of my prepayment(s) during the twelve (12) month period immediately preceding the date of the prepayment exceeds twenty (20) percent of the original Principal amount of this Note. Interest will be calculated using the rate in effect at the time of prepayment."

Krumme's Note contained a prepayment penalty rider, which contained similar terms but provided for a longer "Penalty Period" of 36 months after the date of the Note. In addition, the prepayment penalty in Krumme's Note applied "if the aggregate amount of the principal prepaid in any twelve month period exceeds twenty percent (20%) of the original principal amount." (Underline omitted.) Thus, the borrower could be subject to more than one prepayment penalty during the first three years of the loan.

Although the first amended complaint alleges that all of the Plaintiffs were subject to "draconian" prepayment penalties, the record does not contain a prepayment penalty addendum or rider for Thibault's loan and paragraph 5 of his Note states that he is not subject to a prepayment penalty. Since the loan documents attached to the pleading contradict the allegations of the first amended complaint, we conclude, for the purposes of this appeal, that Thibault's loan did not include a prepayment penalty. (*C.R. v. Tenet Healthcare Corp*. (2009) 169 Cal.App.4th 1094, 1102 [allegations "contrary to . . . a fact of which judicial notice may be taken will be treated as a nullity"].)

Program Disclosures

Perez and Krumme each received a two-page document entitled "ADJUSTABLE RATE MORTGAGE (ARM) LOAN PROGRAM DISCLOSURE[,] MONTHLY TREASURY AVERAGE INDEX (MTA) – PAYMENT CAPS[,]" which described the features of their loans. Thibault received a similar disclosure that referenced a different index. The program disclosures contain tables that use bullet points to describe the features of the loans.

The Perez and Krumme program disclosures start with a box labeled "HOW YOUR INTEREST RATE AND PAYMENT ARE DETERMINED[,]" which contains the following four bullet points: "•Your interest rate will be based on an index rate plus a margin. Please ask us for our current interest rate and margin. [¶] •*The 'Index' is the 'Twelve-Month Average' of the annual yields on actively traded United States Treasury Securities* . . . . [¶] •Your initial interest rate is not based on the Index used to make later adjustments. Please ask us for the amounts of our current interest rate discounts. [¶] •For the first year of your loan, your payment will be based on the initial interest rate, loan amount and loan term. *After the first year, your payment will be calculated as described below*." (Italics added.)

This same section in Thibault's program disclosure, like his Note, refers to a different index and the collection of per diem interest to cover the "[a]dditional days interest collected prior to the first monthly payment due date." It also contains a fifth bullet point, which states: "After the first year, your payment will be based upon the current loan amount (which may be higher than the original loan amount due to deferred interest), remaining loan term, and payment caps. Your interest rate, payments, and loan amount will be calculated as described below."

Each of the program disclosures states that the "interest rate can change" on the first payment date or the third payment date (depending on the type of loan product) "and monthly thereafter." With slight variations in wording, they advised the borrower that "Each time your interest rate changes, the new interest rate will equal the sum of the index plus the margin, subject to the following limits: [¶] •Your interest rate will be rounded to the nearest 1/8 %. [¶] •Your interest rate will never exceed the maximum set forth in your loan documents. The maximum rate will not be more than 9.95%. Please ask us for our current maximum rate."

Under the heading "How Your Payment Can Change[,]" the Perez and Krumme program disclosures state: "Your payment can change: [¶] •Every year and can increase or decrease substantially based on changes in the interest rate. [¶] •At every 5th scheduled payment adjustment, you will need to pay the Full Payment until the next payment adjustment date."

This portion of Thibault's program disclosure contains different language. It advises that the payment can change every 12 months and that "[e]very time your payment changes, it can increase or decrease substantially based on changes in the interest rate and *the amount of deferred interest accrued (known as negative amortization*)." (Italics added.)

Under this same heading, Perez's program disclosure also states: "Your payment will be calculated as follows: [¶] Beginning with the 13th payment and every 12 months thereafter, we will calculate the amounts of the full payment and the limited payment. The full payment will be the amount sufficient to pay the unpaid balance in full by the maturity date at the interest rate in effect during the month preceding the payment change date. The limited payment will be your payment for the month preceding the payment change date increased by 7.5%. You will then have the choice each month of paying the lesser of the two, and if the limited payment is less than the full payment, you can choose to pay more than the limited payment up to and including the full payment for your monthly payment. If you pay anything less than the Full Payment, which would not be sufficient to cover the interest due, the difference will be added to your loan amount. This means the balance of your loan could increase. This is known as 'negative amortization'."

Krumme's and Thibault's program disclosures contain similar language, except they also advised that the "Minimum Payment" the borrower must make each month is "the lesser of the Full Payment or the Limited Payment." Krumme's program disclosure advised that the lender may provide "other monthly payment options that are greater than the Minimum Payment," but did not describe those options. Thibault's program disclosure advised that he "may have up to 3 additional payment options, as long as they are greater than the Minimum Payment" and described the three options: "Interest Only," "Amortized Payment," and "15[-]Year Amortized Payment."

Federal Truth-in-lending Disclosure Statements

The TILDS forms include the following information in a series of boxes near the top of the form: (1) the "ANNUAL PERCENTAGE RATE [¶] The cost of your credit as a yearly rate": 5.165 percent for Perez, 6.783 percent for Krumme, and 7.403 percent for Thibault; (2) the "FINANCE CHARGE [¶] The dollar amount the credit will cost you"; (3) the "Amount Financed"; and (4) "Total of Payments [¶] The amount you will have paid after you have made all payments as scheduled."

The TILDS forms displayed payment schedules for each borrower.

Perez's payment schedule provided:

NUMBER OF PAYMENTS	AMOUNT OF PAYMENTS	WHEN PAYMENTS ARE DUE
12	1,852.64	MONTHLY BEGINNING 09/01/2005
12	1,991.59	MONTHLY BEGINNING 09/01/2006
12	2,140.96	MONTHLY BEGINNING 09/01/2007
12	2,301.53	MONTHLY BEGINNING 09/01/2008
12	2,474.14	MONTHLY BEGINNING 09/01/2009
299	3,524.95	MONTHLY BEGINNING 09/01/2010
1	3,527.20	LAST PAYMENT DUE 08/01/2035

Krumme's payment schedule provided:

NUMBER OF PAYMENTS	AMOUNT OF PAYMENTS	PAYMENTS ARE DUE MONTHLY BEGINNING
12	864.19	01/01/2006
12	929.00	01/01/2007
12	998.68	01/01/2008
12	1,073.58	01/01/2009
12	1,154.10	01/01/2010
300	1,923.12	01/01/2011

Thibault's payment schedule provided:

NUMBER OF PAYMENTS	AMOUNT OF PAYMENTS	WHEN PAYMENTS ARE DUE
12	1,870.55	MONTHLY BEGINNING 05/01/2006
12	2,010.84	MONTHLY BEGINNING 05/01/2007
12	2,161.65	MONTHLY BEGINNING 05/01/2008
12	2,323.77	MONTHLY BEGINNING 05/01/2009
11	2,498.05	MONTHLY BEGINNING 05/01/2010
300	4,542.60	MONTHLY BEGINNING 04/01/2011
1	4,545.61	LAST PAYMENT DUE 04/01/2036

The TILDS forms also stated: (1) "**VARIABLE RATE FEATURE**: [¶] This loan has a Variable Rate Feature. Variable Rate Disclosures have been provided to you earlier"; and (2) "PREPAYMENT: If you pay off your loan early, you [¶] may . . . have to pay a penalty."

In *Boschma*, the court observed that the TILDS forms at issue in that case did "*not explain* how the initial payments for the first 12 months of the payment schedule . . . or the ensuing increases in monthly payments in the TILDS payment schedule were calculated." (*Boschma*, *supra*, 198 Cal.App.4th at pp. 240-241.) Although the payment amounts on the TILDS forms for the first year were the same as those listed in paragraph 3(B) of the notes, the court observed that none of the loan documents explained how those numbers were derived. (*Id.* at p. 241.) But the court was able to "reverse engineer[]" the initial payment amounts by using the principal in paragraph 1 of the note, taking the interest rate listed in paragraph 2(A) of the note, and calculating the monthly payment for a 30-year fixed rate mortgage using a mortgage calculator. (*Ibid.*)

As in *Boschma*, the TILDS forms in this case do not explain how the initial payments for the first 12 months of the payment schedule ($1,852.64 for Perez, $864.19 for Krumme, and $1,870.55 for Thibault), or the ensuing increases in monthly payments in the TILDS payment schedule were calculated. And as in *Boschma*, paragraph 3(B) of each Note in this case, sets forth the "Initial Monthly Payments" for the borrowers ($1,852.64 for Perez, $864.19 for Krumme, and $1,870.55 for Thibault). Although neither the TILDS nor the notes explain where these numbers came from, they can be "reverse engineered" by applying the method used in *Boschma*: (1) identifying the principal amount from paragraph 1 of the Note ($576,000 for Perez; $250,400 for Krumme; & $542,000 for Thibault); (2) selecting the discounted interest rate listed in section 2(A) of the Note (1.0 percent for Perez, 1.5 percent for Krumme and Thibault), *not* the APR (annual percentage rate) listed in the TILDS; and (3) using a mortgage calculator, calculating the monthly payment for a 30-year fixed rate, fully amortizing loan. (*Boschma*, *supra*, 198 Cal.App.4th at p. 241.) For the Perez, $576,000 borrowed at 1.0 percent results in 360 equal payments of $1,852.64. For Krumme, $250,400 borrowed at 1.5 percent equals 360 payments of $864.19. For Thibault, $542,000 borrowed at 1.5 percent results in 360 equal payments of $1,870.55.

But these are not fixed rate mortgages. As we have noted, the actual interest charged on each loan was based on an index plus a margin. The margins were 2.525 percent for Perez, 3.45 percent for Krumme, and 4.025 percent for Thibault. The record does not indicate the index amounts when the loans closed. Presumably, the interest rates shown on the TILDS forms were based on the index plus margin amounts that were in effect on the dates the loans closed. At closing, the interest rate on Perez's TILDS was 5.165 percent, Krumme's was 6.783 percent, and Thibault's was 7.403 percent. This suggests that the indices used ranged from 2.64 to 3.38 percent when

Plaintiffs' loans closed.[6] And as explained in section 2(B) of the Notes, the actual interest rate could change monthly, if the index changed.

As the payment schedules demonstrate, after five years, the payments increased more dramatically. At that point, Perez's payments went from $2,474.14 per month to $3,524.95 per month; Krumme's payments went from $1,154.10 to $1,923.12 per month; and Thibault's payments went from $2,498.05 to $4,542.60 per month. "These increases presumably reflect sections 3(E), 3(F), and 3(G) of the Note, which collectively limit the amount of negative amortization that may occur and require the borrower to eventually start making a payment that will amortize the loan regardless of the 7.5 percent limitation set forth in section 3(D)." (*Boschma*, *supra*, 198 Cal.App.4th at p. 242.)

PROCEDURAL HISTORY

Allegations of First Amended Complaint

The gravamen of the first amended complaint here is that Defendants failed to disclose the following before Plaintiffs entered into their Option ARM's: (1) "the loans were designed to cause and would cause negative amortization to occur"; (2) "the initial interest rate for [each] loan was a 'teaser' rate that was substantially lower than the actual interest rate that would be charged on the loan . . . ."; (3) "the monthly payment amounts listed in the loan documents for the first two to five years of the loans were based entirely upon the 'teaser' rate (though not disclosed as such by Defendants), such that these payment amounts would be insufficient to pay the interest due each month"; and (4) "when [Plaintiffs] followed the payment schedule included in the loan documents, negative amortization was certain to occur, resulting in a significant loss of equity in

[6] Perez's interest rate on the TILDS (5.165 %) less the margin (2.525 %) equals 2.64 percent; Krumme's TILDS interest rate (6.783 %) less her margin (3.45 %) equals 3.333 percent; Thibault's TILDS interest rate (7.403 %) less his margin (4.025 %) equals 3.378 percent.

borrowers' homes, and making it much more difficult for borrowers to refinance the loans [because they would have "to pay another set of closing costs," plus a "substantial prepayment penalty"]; thus, as each month passed, the homeowners would actually owe more money than they did at the outset of the loan, with less time to repay it." (Fn. omitted.) (Cf. *Boschma*, *supra*, 198 Cal.App.4th at page 242.) In addition, "this negative amortization or 'deferred interest' was added to the principal balance and, in turn, accrued more interest – in effect using compound interest to increase the balance owed by each borrower."

Plaintiffs allege that "Defendants knew [negative amortization] was certain to occur because of the large spread between the temporary teaser rate and the combined index and margin" and that "based on the sole . . . payment schedule that Defendants provided to the borrowers before they entered into the loans . . . , the Option ARM loans at issue would always cause, and were designed to cause, negative amortization." Instead of clearly describing the consequences of making the minimum payments in the TILDS payment schedule, "Countrywide made the deceptive partial representation that negative amortization was only a mere possibility," when in actuality, making payments in accordance with the only payment schedule provided to Plaintiffs "was absolutely certain to cause negative amortization." "Defendants did not provide Plaintiffs, before they entered into the loans, with any other payment schedule or with any informed option to make payments different from those listed in the [TILDS] payment schedule." "[H]ad Defendants disclosed the payment amounts sufficient to avoid negative amortization from occurring . . . [Plaintiffs] would not have entered into the loans."

Plaintiffs allege Defendants actively concealed and suppressed material facts. "Defendants purposefully and intentionally devised this Option ARM loan scheme of stating only partially true facts and omitting important material information in order to deceive consumers into believing that these loans would provide a low-interest rate for the first several years of the loan term and that, if they made their payments according to the payment schedule provided by Defendants, this would be sufficient to pay both principal and interest." Plaintiffs allege that the Notes, TILDS forms, program disclosures, and deeds of trust were all misleading and deceptive. They assert that while the loan documents given to borrowers were deceptive, Countrywide disclosed the nature of the loan and the certainty of negative amortization to their investors.

Regarding their section 17200 claim, Plaintiffs allege Defendants' practices were unlawful, unfair, and fraudulent.

Plaintiffs allege "damages, which include, but are not limited to, the loss of equity in their homes." They also request punitive damages.[7]

The allegations of Plaintiffs' first amended complaint are substantially similar to those in *Boschma*, which we have set forth in the margin.[8]

---

[7] We note also that Plaintiffs have sued on behalf of themselves and "all others similarly situated." The current procedural posture of the case renders class action issues irrelevant. Our discussion will focus on whether the named plaintiffs have stated or can state a cause of action. (*Boschma*, *supra*, 198 Cal.App.4th at p. 234, fn. 1.)

[8] The plaintiffs in *Boschma* alleged that the lender: "failed to disclose prior to plaintiffs' entering into their Option ARM's: (1) 'the loans were designed to cause negative amortization to occur'; (2) 'the monthly payment amounts listed in the loan documents for the first two to five years of the loans were based entirely upon a low "teaser" interest rate (though *not* disclosed as such by Defendants) which existed for only a single month and which was substantially lower than the actual interest rate that would be charged, such that these payment amounts would never be sufficient to pay the interest due each month'; and (3) 'when [plaintiffs] followed the contractual payment schedule in the loan documents, negative amortization was *certain* to occur, resulting in a significant loss of equity in borrowers' homes, and making it much more difficult for borrowers to refinance the loans [because of the prepayment penalty included in the loan for paying off the loan within the first three years of the loan]; thus, as each month passed, the homeowners would actually owe more money than they did at the outset of the loan, with less time to repay it.' " (*Boschma*, *supra*, 198 Cal.App.4th at p. 242.) The *Boschma* plaintiffs alleged "that instead of clearly describing the consequences of making the scheduled payments set forth in the TILDS, the actual disclosures in the loan documents suggest only that negative amortization *could* occur and that payments *may* change from the original schedule based on future variability in interest rates. 'Borrowers were *not*
(continued)

Demurrers Sustained Without Leave to Amend

Amnet and Countrywide filed separate demurrers challenging the first amended complaint. Countrywide argued that the loan documents contradicted Plaintiffs' allegations and that the purported omissions and misrepresentations were disclosed on the face of the Notes and other loan documents. Countrywide argued that the payment schedules complied with federal law, which did not require the disclosure of the " 'certainty' of negative amortization" in the TILDS. Countrywide asserted that the loan documents adequately described the circumstances in which negative amortization could occur and adequately disclosed that the initial interest rate was discounted. Countrywide also argued that it could not be held liable for Amnet's alleged omissions to Krumme and that federal law governing consumer credit disclosures preempted Plaintiffs' claims.

---

provided, before entering into the loans, with any other payment schedule or with any informed option to make payments different than those listed in the [TILDS] payment schedule.' '[H]ad Defendant disclosed the payment amounts sufficient to avoid negative amortization from occurring [plaintiffs] would not have entered into the loans.' " (*Ibid.*) The *Boschma* plaintiffs asserted that "this information was material to their decision to accept Option ARM's and they would not have entered into their Option ARM's had defendant made accurate disclosures" and that "defendant actively concealed and suppressed material facts from [the] plaintiffs." (*Ibid.*) They claimed the " 'Defendants purposefully and intentionally devised this Option ARM loan scheme of flatly omitting material information and, in some cases, making partial representations while omitting material facts, in order to deceive consumers into believing that these loans would provide a low payment and corresponding interest rate for the first two to five years of the Note and that, if they made their payments according to the payment schedule provided by Defendants, this would be sufficient to pay both principal and interest.' " (*Id.* at p.p. 242-243.) The *Boschma* plaintiffs "allege[d] damages consisting of loss of equity in their homes and other unspecified damages. [¶] With regard to their section 17200 claim, [they alleged the] defendant's practices . . . were unlawful, unfair, and fraudulent" and identified their " 'injury and lost money and property' as 'the amount of negative amortization resulting from [the] [d]efendant's scheme.' " (*Id*. at p. 243.)

Amnet argued that it had disclosed the allegedly concealed facts, that the first amended complaint acknowledged that negative amortization was not certain to occur, and that Krumme had not pleaded justifiable reliance.

Defendants asked the trial court to judicially notice the superior court's order in *Boschma* and relied on the reasoning in that order in their opposition papers. However, the plaintiffs in *Boschma* appealed the trial court order in that case six weeks before Defendants filed their opposition papers and the issue was pending in the Court of Appeal. As we have stated, the trial court's order in *Boschma* was reversed on appeal.

The court sustained Defendants' demurrers without leave to amend and entered a judgment of dismissal.[9] In its order sustaining the demurrer, the court stated that the matters that were allegedly concealed or omitted "were actually disclosed by the loan documents attached to the complaint and therefore contradicted Plaintiffs' allegations." The court held that: (1) "the loans are not designed to and do not necessarily cause negative amortization as they clearly disclose that it will occur only if the minimum payment is not sufficient to cover the amount of interest due and Borrowers *chose* to not pay more than the minimum payment"; (2) "[t]he loan documents clearly disclose that the interest rate will change after the first month as it would then be tied to a fluctuating

---

[9] After the court issued its order on the demurrers, Amnet obtained a judgment of dismissal. Although the record contains a copy of a proposed judgment of dismissal prepared by Countrywide's counsel, it does not contain a judgment of dismissal that has been executed by the court. "The general rule of appealability is this: 'An order sustaining a demurrer without leave to amend is not appealable, and an appeal is proper only after entry of a dismissal on such an order.' [Citation.] But 'when the trial court has sustained a demurrer to all of the complaint's causes of action, appellate courts may deem the order to incorporate a judgment of dismissal, since all that is left to make the order appealable is the formality of the entry of a dismissal order or judgment.' " (*Melton v. Boustred* (2010) 183 Cal.App.4th 521, 528, fn.1 (*Melton*).) Although the record does not contain a judgment dismissing Countrywide, we deem the order sustaining Countrywide's demurrer without leave to amend " 'to incorporate a judgment of dismissal and will review the order.' " (*Ibid.*)

index" plus the margin; and (3) the loan documents "clearly disclose that in certain circumstances making payments less than the interest rate will result in increasing debt." The court reasoned that Plaintiffs' allegations that Defendants had failed to disclose and that the loans were guaranteed to cause negative amortization were legal conclusions, not allegations of fact that the court was required to accept as true at the pleading stage, and that the interpretation of the loan documents is a question of law for the court.

DISCUSSION

Standard of Review

"A general demurrer searches the complaint for all defects going to the existence of a cause of action and places at issue the legal merits of the action on assumed facts." (*Carman v. Alvord* (1982) 31 Cal.3d 318, 324.)

"On appeal from a judgment of dismissal after a demurrer is sustained without leave to amend, the reviewing court assumes the truth of all facts properly pleaded by the plaintiff. [Citation.] 'We also accept as true all facts that may be implied or reasonably inferred from those expressly alleged. [Citation.]' . . . But we do not assume the truth of ' " 'contentions, deductions or conclusions of fact or law.' " ' " (*Trinity Park, L.P. v. City of Sunnyvale* (2011) 193 Cal.App.4th 1014, 1026 (*Trinity Park*), citing *Evans v. City of Berkeley* (2006) 38 Cal.4th 1, 6.)

"We also consider matters that may be judicially noticed. (Code Civ. Proc., § 430.30, subd. (a); *Schifando*, *supra*, 31 Cal.4th at p. 1081.) Among other things, the Evidence Code provides that judicial notice may be taken of '[f]acts and propositions that are not reasonably subject to dispute and are capable of immediate and accurate determination by resort to sources of reasonably indisputable accuracy.' (Evid. Code, § 452, subd. (h).) We may therefore take judicial notice of an agreement where 'there is and can be no factual dispute concerning the contents of the agreements. [Citation.]' [Citation.] However, we keep in mind the general rule that '[w]hen judicial notice is taken of a document . . . the truthfulness and proper interpretation of the document are disputable. [Citation.]' (*StorMedia Inc. v. Superior Court* (1999) 20 Cal.4th 449, 457, fn. 9.)" (*Trinity Park, supra*, 193 Cal.App.4th at pp. 1026-1027.)

" 'We also consider the complaint's exhibits. [Citations.] Under the doctrine of truthful pleading, the courts "will not close their eyes to situations where a complaint contains allegations of fact inconsistent with attached documents, or allegations contrary to facts which are judicially noticed." [Citation.] "False allegations of fact, inconsistent with annexed documentary exhibits [citation] or contrary to facts judicially noticed [citation], may be disregarded . . . ." [Citations.]' " (*Trinity Park, supra*, 193 Cal.App.4th at p. 1027.)

After reviewing the allegations of the complaint, the exhibits to the complaint, and matters properly subject to judicial notice, we exercise our independent judgment on the question whether the complaint states a cause of action as a matter of law. (*Moore v. Regents of University of California* (1990) 51 Cal.3d 120, 125.) In exercising our independent judgment, " 'we give the complaint a reasonable interpretation, reading it as a whole and its parts in their context.' " (*Melton*, *supra*, 183 Cal.App.4th at p. 528.) "On appeal, 'the plaintiff bears the burden of demonstrating that the trial court erred' in sustaining the demurrer." (*Ibid.*)

Where, as here, the trial court sustained a demurrer without leave to amend, we review the court's determination that no amendment could cure the defect in the complaint for abuse of discretion. (*Schifando, supra*, 31 Cal.4th at p. 1081.) "If we see a reasonable possibility that the plaintiff could cure the defect by amendment, then we conclude that the trial court abused its discretion in denying leave to amend. If we determine otherwise, then we conclude it did not. [Citation.] The plaintiff has the burden of proving that an amendment would cure the defect. [Citation.]" (*Campbell v. Regents of University of California* (2005) 35 Cal.4th 311, 320.)

Federal Truth in Lending Act (TILA)

As the court observed in *Boschma*, "there are a plethora of federal district court opinions addressing whether borrowers can state a claim under the federal Truth in Lending Act (TILA; 15 U.S.C. § 1601 et seq.) and related state law causes of action based on allegedly fraudulent, unlawful, and unfair Option ARM disclosures." (*Boschma*, *supra*, 198 Cal.App.4th at pp. 243-244.) Although Plaintiffs do not allege a TILA claim or base their section 17200 claim on alleged violations of TILA, we begin with a discussion of TILA because it mandates certain disclosures by lenders in the mortgage industry, provides the context for the disclosures made by Defendants, and therefore informs our analysis. (*Id.* at p. 244.)

"TILA, title 15 of the United States Code section 1601 et seq., and its accompanying regulations (Regulation Z), 12 Code of Federal Regulations part 226.1 et seq. (2011), require specific disclosures by businesses offering consumer credit (including mortgage loans). TILA's purpose is to 'avoid the uninformed use of credit.' (15 U.S.C. § 1601(a).) TILA grants the Board of Governors of the Federal Reserve System power to prescribe regulations and carry out the purposes of TILA. (15 U.S.C. §§ 1602(c), 1604(a).) Subject to certain exceptions, TILA does not 'annul, alter, or affect the laws of any State relating to the disclosure of information in connection with credit transactions, except to the extent that those laws are inconsistent with the provisions of this subchapter, and then only to the extent of the inconsistency.' (15 U.S.C. § 1610(a)(1).) Thus, the existence of TILA does not necessarily preempt [P]laintiffs' state law claims." (*Boschma*, *supra*, 198 Cal.App.4th at p. 244.)

"Regulation Z obligates creditors providing 'closed-end credit' (such as a mortgage) to 'make the disclosures required by this subpart clearly and conspicuously in writing, in a form that the consumer may keep.' (12 C.F.R. § 226.17(a)(1) (2011).) 'This standard requires that disclosures be in a reasonably understandable form. For example, while the regulation requires no mathematical progression or format, the disclosures must be presented in a way that does not obscure the relationship of the terms to each other.' (12 C.F.R. § 226, Supp. I, par. 17(a)(1) (2011).)" (*Boschma*, *supra*, 198 Cal.App.4th at pp. 244-245.)

"Variable rate mortgage borrowers must be provided with '[a] loan program disclosure' that includes '[a]ny rules relating to changes in the index, interest rate, payment amount, and outstanding loan balance including, for example, an explanation of interest rate or payment limitations, negative amortization, and interest rate carryover.' (12 C.F.R. § 226.19(b)(2)(vii).) 'If the initial interest rate will be a discount or a premium rate, creditors must alert the consumer to this fact.' (12 C.F.R. § 226, Supp. I, par. 19(b)(2)(v)(1) (2011).) 'A creditor must disclose, where applicable, the possibility of negative amortization. For example, the disclosure might state, "If any of your payments is not sufficient to cover the interest due, the difference will be added to your loan amount." . . . If a consumer is given the option to cap monthly payments that may result in negative amortization, the creditor must fully disclose the rules relating to the option, including the effects of exercising the option (such as negative amortization will occur and the principal loan balance will increase) . . . .' (12 C.F.R. § 226, Supp. I, par. 19(b)(2)(vii)2 (2011).)" (*Boschma*, *supra*, 198 Cal.App.4th at p. 245.)

General Discussion of Federal District Court Cases

A number of federal district court cases involving similar Option ARM loan documents have addressed the question whether the borrower can state a cause of action under TILA, as well as causes of action based on state law fraud, contract, or UCL claims.

With regard to TILA claims, the *Boschma* court observed, "A string of cases . . . have held that a borrower states a claim for a violation of TILA based on, among other disclosure deficiencies, the failure of the lender to clearly state that making payments pursuant to the TILDS payment schedule *will* result in negative amortization during the initial years of the loan." (*Boschma*, *supra*, 198 Cal.App.4th at p. 245, citing *Romero v.*

Countrywide Bank, N.A. (N.D.Cal. 2010) 740 F.Supp.2d 1129, 1132–1133, 1136–1141 (*Romero*); *Ralston v. Mortgage Investors Group, Inc*. (N.D.Cal., Mar. 16, 2009, No. C 08-536 JF (RS)) 2009 WL 688858, pp. *1–*2, *5–*6 (*Ralston I*); *Velazquez, supra,* 605 F.Supp.2d at pp. 1053–1056, 1064–1066; *Pham v. T.J. Financial, Inc*. (C.D.Cal., Aug. 11, 2008, No. CV 08-275 ABC (JCx)) 2008 WL 3485589, pp. *2–*4; and *Plascencia v. Lending 1st Mortgage, supra,* 583 F.Supp.2d at pp. 1092-1097.)

"*Velazquez*, . . . clearly and concisely states the reasoning relied upon by these courts with regard to the issue of negative amortization: 'All disclosures framed negative amortization as a possibility. The disclosures are perhaps literally accurate: they state that paying less than the full amount is an option under the Note, they state how negative amortization would occur, and the payment schedule provided in the TILDS appears to reflect (without using the term) negative amortization. In fact, however, if the Plaintiffs were to exercise the payment cap [and make monthly payments in accordance with the payment schedule included in the TILDS], negative amortization was certain to occur.' *Velazquez* concluded that the plaintiffs 'may be able to show' a lack of clear and conspicuous TILA disclosures pertaining to negative amortization. [Citation.] With regard to disclosure of the use of a discounted initial interest rate . . . in the program disclosure, *Velazquez* observed: 'Plaintiffs may be able to show that, when taken in conjunction with the disclosure in the Note and the TILDS, [the program disclosure] is not clear and conspicuous as required by TILA.' " (*Boschma*, *supra*, 198 Cal.App.4th at pp. 245-246, citing *Velasquez*, *supra*, 605 F.Supp.2d at pp. 1065-1067.)

The *Boschma* court found the federal district court cases cited above persuasive and concluded that other district court cases reaching contrary results were inapposite or unconvincing. (*Boschma*, *supra*, 198 Cal.App.4th at p. 246, citing as unpersuasive *Taylor v. Homecomings Financial, LLC* (N.D.Fla. 2010) 738 F.Supp.2d 1257, 1267 (*Taylor*); *Wallace v. Midwest Financial & Mortgage Services, Inc*. (E.D.Ky. 2010) 728 F.Supp.2d 906, 917–918 (*Wallace*) [summary judgment on TILA claim granted; court observed that the plaintiff cited no case law, statutes, or regulations that supported his claim that the loan disclosures " 'were inadequate under TILA' "]; *Conder, supra*, 680 F.Supp.2d at pp. 1172–1174 [motion to dismiss TILA claim granted; plaintiff did not allege loan failed to disclose certainty of negative amortization by paying according to payment schedule].)

Regarding state law claims, as *Boschma* observed, some federal district court cases that allowed TILA claims to proceed past the motion to dismiss stage, have also held that the plaintiffs alleged sufficient facts to support state law fraud and unfair business practices claims based on the same underlying facts. (*Boschma*, *supra*, 198 Cal.App.4th at p. 247, citing *Ralston I, supra*, 2009 WL 688858, pp. *7–*8; *Velazquez, supra*, 605 F.Supp.2d at pp. 1067–1068; *Amparan v. Plaza Home Mortgage, Inc.*, *supra,* 678 F.Supp.2d at pp. 975–977.) In addition, other federal district court cases have concluded that even though the borrowers could not state valid TILA claims, their pleadings stated valid fraud and section 17200 claims under state law. (*Boschma*, at p. 247, citing *Jordan v. Paul Financial, LCC* (N.D.Cal. 2010) 745 F.Supp.2d 1084, 1095–1100 (*Jordan*) [allowing UCL claim to proceed on fraudulent and unfair prongs but not unlawful prong]; *Ralston v. Mortgage Investors Group, Inc*. (N.D.Cal., Aug. 12, 2010, No. C 08-536 JF (PVT)) 2010 WL 3211931, pp. *3–*6 (*Ralston II*); *Brooks, supra,* 2010 WL 2680265, pp. *1–*3, *9–*13.)

As we have noted, Plaintiffs do not allege a TILA claim or allege a TILA violation as the basis for their state law UCL claim. With this background in mind, we turn to the questions whether Plaintiffs' first amended complaint is sufficient to state causes of action for fraud and violations of the UCL.

Fraud

Under our Civil Code, "[f]raud is either actual or constructive." (Civ. Code, § 1571.) Actual fraud includes "[t]he suppression of that which is true, by one having knowledge or belief of the fact" or "[a]ny other act fitted to deceive." (Civ. Code, § 1572, subds. 3, 5.) And "deceit" includes "[t]he suppression of a fact, by one who is bound to disclose it, or who gives information of other facts which are likely to mislead for want of communication of that fact." (Civ. Code, § 1710, subd. (3); see also *Vega v. Jones, Day, Reavis & Pogue* (2004) 121 Cal.App.4th 282, 292 (*Vega*) ["active concealment or suppression of facts . . . is the equivalent of a false representation"].) "Actual fraud is always a question of fact." (Civ. Code, § 1574.)

" '[T]he elements of an action for fraud and deceit based on concealment are: (1) the defendant must have concealed or suppressed a material fact, (2) the defendant must have been under a duty to disclose the fact to the plaintiff, (3) the defendant must have intentionally concealed or suppressed the fact with the intent to defraud the plaintiff, (4) the plaintiff must have been unaware of the fact and would not have acted as he did if he had known of the concealed or suppressed fact, and (5) as a result of the concealment or suppression of the fact, the plaintiff must have sustained damage.' " (*Hahn v. Mirda* (2007) 147 Cal.App.4th 740, 748.) Fraud must be pleaded with specificity rather than with " 'general and conclusory' " allegations. (*Small v. Fritz Companies, Inc*. (2003) 30 Cal.4th 167, 184.) But "[l]ess specificity is required when 'it appears from the nature of the allegations that the defendant must necessarily possess full information concerning the facts of the controversy' " or " 'when the facts lie more in the knowledge of the opposite party . . . .' " (*Committee on Children's Television, Inc. v. General Foods Corp.* (1983) 35 Cal.3d 197, 217, superseded by statute on other grounds as stated in *Californians for Disability Rights v. Mervyn's, LLC* (2006) 39 Cal.4th 223, 227.)

We agree with the *Boschma* court that the enhanced pleading burden of a fraud claim is met by attaching the relevant loan documents. " '[P]laintiffs' evidence is the mortgage instrument, which provides the specific content of the allegedly false representations related to negative amortization, as well as the date and place of the alleged fraud. While the precise identities of the employees responsible . . . are not specified in the loan instrument, defendants possess the superior knowledge of who was responsible for crafting these loan documents.' " (*Boschma*, *supra*, 198 Cal.App.4th at p. 248.)

First element: Did Plaintiffs adequately plead concealed or suppressed material facts?

The trial court concluded that Plaintiffs' fraud cause of action "fail[ed] at the first element."[10]

The gravamen of the first amended complaint is that the Option ARM's were designed to cause negative amortization and that the loan documents were misleading since they described negative amortization as a possibility when in fact it was certain to occur if the borrowers made the minimum payments required under the loans, as set forth in the only payment schedule provided to them. Plaintiffs assert that negative amortization was certain to occur because (1) the initial "teaser" interest rate was substantially lower than the actual interest rate charged, and (2) the minimum payments required during the first few years, which were based on the "teaser" rate, would be insufficient to pay the interest that actually accrued each month.

We agree with the court in *Boschma*, that whether Defendants can be deemed to have concealed or suppressed material facts is a close question since "at least some of these facts *can be* distilled from the loan documents through careful analysis of the Note[s]," program disclosures, and TILDS forms. (*Boschma*, *supra*, 198 Cal.App.4th at p. 248.) We agree with the court's conclusion in *Boschma* that the actual interest rates and monthly payment amounts necessary "to amortize the loan (or at least pay the accruing interest) were hidden in the complexity of the Option ARM contract terms." (*Id*. at p. 249.) As the court stated in *Boschma*, while the lenders "did not omit any mention of negative amortization" they "did not clearly state in the loan documents that

[10] The trial court issued its ruling months before the appellate court filed its decision in *Boschma* and, therefore, did not have the benefit of the reasoning in *Boschma*.

[the] plaintiffs *were receiving* a discounted initial interest rate and that making the minimum payments according to the TILDS payment schedule *definitely would* result in negative amortization." (*Ibid.*)

As we shall explain, the loan documents used conditional language, which supports the Plaintiffs' assertion that the loan documents failed to disclose that negative amortization was certain to occur. All three Notes contain the following references to negative amortization: (1) In the introduction—". . . **THERE MAY BE A LIMIT ON THE AMOUNT THAT THE MONTHLY PAYMENT CAN INCREASE OR DECREASE.** ***THE PRINCIPAL AMOUNT TO REPAY COULD BE GREATER THAN THE AMOUNT ORIGINALLY BORROWED***, ..."; (2) in paragraph 1—"The Principal amount *may* increase . . . but will never exceed 115 percent of the Principal amount I originally borrowed"; (3) in paragraph 3(C)—"*If* the Minimum Payment is not sufficient to cover the amount of the interest due *then* negative amortization will occur"; (4) in paragraph 3(E)—"Since my monthly payment amount changes less frequently than the interest rate, and since the monthly payment is subject to the payment limitations described in Section 3(D), my Minimum Payment *could be less than or greater than the amount* of the interest portion of the monthly payment that would be sufficient to repay the unpaid Principal I owe . . . . , the Note Holder will subtract the amount of my monthly payment from the amount of the interest portion and will add the difference to my unpaid Principal, and interest will accrue on the amount of this difference at the interest rate required by Section 2"; and (5) in paragraph 3(F)—"My unpaid Principal can never exceed the Maximum Limit equal to ONE HUNDRED FIFTEEN percent (115%) of the Principal amount I originally borrowed. My unpaid Principal *could* exceed that Maximum Limit due to Minimum Payments and interest rate increases." (Italics added.)

On the subject of negative amortization, the Krumme program disclosures stated: "*If* you pay less than the Full Payment, then the payment *may not* be enough to cover the interest due, and any difference will be added to your principal balance. This means the balance of your loan *could* increase. This is known as 'negative amortization.' " (Italics added.) Perez's program disclosure contained similar language.

Thibault's program disclosure contained the following references to negative amortization in two separate sections: (1) "After the first year, your payment will be based upon the current loan amount (*which may be higher than the original loan amount due to deferred interest*), remaining loan terms, and payment caps"; and (2) "Every time your payment changes, it *can* increase or decrease substantially based on changes in the interest rate and *the amount of deferred interest accrued (known as negative amortization*)." (Italics added.) Although these disclosures suggest that negative amortization can occur, they do not explain how it might occur, and thus provide less information than the Perez and Krumme disclosures.

Unlike the program disclosure in *Boschma*, which stated in the first paragraph, in all capital letters: " 'THIS LOAN ALLOWS FOR NEGATIVE AMORTIZATION' " and contained a section entitled " 'DEFERRED INTEREST,' " which explained that " 'Deferred interest' " is " 'also known as Negative Amortization,' " the program disclosures in this case bury this information in regular text in boxes in the middle of the forms. (*Boschma*, *supra*, 198 Cal.App.4th at pp. 238, 239.) The TILDS forms do not mention negative amortization.

As the italicized language above demonstrates, the loan documents used conditional language, phrases like "principal *may* increase," "amount to repay *could be* greater," "*if* the minimum payment is not sufficient," "Minimum payment *could be less than or greater than* the interest [actually accruing]," which suggested that negative amortization was a possibility. But Plaintiffs contend that negative amortization was an absolute certainty and that the loan documents were misleading because they failed to disclose that negative amortization was certain to occur if the borrower made the minimum payments in accordance with the payment schedule. The conditional language of the loan documents supports this allegation.

The Notes stated (using Perez's Note as an example), in relevant part: (1) paragraph 2(A)—"I will pay interest at a yearly rate of 1.000%. The interest rate I will pay may change"; (2) paragraph 2(B)—"The interest rate I will pay may change on the first day of SEPTEMBER, 2005, and on that day every month thereafter"; and (3) paragraph 3(B)—"Each of my initial monthly payments until the first Payment Change Date will be in the amount of U.S. $1,852.64." The program disclosure stated: "•Your initial interest rate is not based on the Index used to make later adjustments. Please ask us for the amounts of our current interest rate discounts. [¶] •For the first year of your loan, your payment will be based on the initial interest rate, loan amount and loan term." Perez's TILDS showed an annual percentage rate of 5.165 percent. Thus, the loan documents contained inconsistent representations regarding the interest rate.

Although the actual interest charged was based on an index plus a margin, the minimum payments required during the first year of the loans were based on discounted interest rates, which Plaintiffs refer to as "teaser" rates. We note that the initial discounted interest rates that were used to calculate the minimum payments were all less than half the value of the margins and much less than the actual interest accruing at the start of the loans. For example, the "teaser" rate for Perez was 1.0 percent, while his margin was 2.525 percent and his variable interest rate the day the loan closed was 5.165 percent. The "teaser" rate for Krumme was 1.5 percent, her margin was 3.45 percent, and her variable interest rate the day the loan closed was 6.783 percent. Thibault's "teaser" rate was 1.5 percent, his margin was 4.025 percent, and his initial variable interest rate was 7.403 percent.

Although interest rates could change monthly, the minimum payment amount required under the Notes changed every 12 months. For example, the first payment change date for Perez was September 1, 2006, and during the first five years, the minimum payment amount changed every September first thereafter. And although the TILDS payment schedules show steadily increasing payment amounts, the amounts by which the minimum payments increased in the first five years were capped. During the first five years, each yearly payment increase was derived by increasing the prior payment by 7.5 percent (multiplying by 1.075, as specified in the paragraph 3(D) of the Notes). For example, Perez's initial minimum payment was $1,852.64; it increased to $1,991.59 in the second year ($1,852.64 x 1.075 = $1,991.59). Applying this same mathematical calculation, Perez's minimum payments increased to $2,140.96 for the third year, $2,301.53 for the fourth year, and $2,474.14 for the fifth year.[11] Similar calculations apply to the payments shown on Krumme's TILDS and Thibault's TILDS. Thus, the minimum payment amounts listed in the TILDS for the first five years were all mathematically derived from the initial "teaser" rate.

Although the Notes disclose the "teaser" interest rates used to calculate the first year's minimum payments and a mathematical formula for determining the amounts of the minimum payments for the second through fifth years, none of the loan documents advise how those minimum payments compare to actual interest accruing on the loans. "The root of the alleged deficiencies in [Defendants'] disclosures is [Defendants'] use of a significantly discounted teaser rate rather than an initial rate set near the rate that would result from the application of the variable rate formula in the Note" (the index plus the margin). (*Boschma, supra*, 198 Cal.App.4th at pp. 249-250.)

Plaintiffs allege that negative amortization was certain to occur if they paid only the minimum amounts shown on the payment schedules and that they each suffered a loss of equity and increased indebtedness due to negative amortization. Countrywide counters that "negative amortization is not a certainty with these loan products, because it depends on the borrower's choice to use the minimum payment option under circumstances where the amount due does not cover the interest due." Addressing these same arguments, the

[11] The calculations are: $1,991.59 x 1.075 = $2,140.96; $2,140.96 x 1.075 = $2,301.53; and $2,301.53 x 1.075 = $2,474.14.

court in *Brooks* concluded that "[t]here never was a possibility that *all* of the payments listed on the Payment Scheudle would cover all of the interest at the rate required to repay the loan. Despite this, the concept of negative amortization was described only as a possibility throughout the Note and the Disclosure." (*Brooks*, *supra*, 2010 WL 2680265, p. *8.)

Although the first amended complaint was filed more than four years after Plaintiffs entered into their loans, it does not indicate the amounts of the actual interest they were charged during those years, how their minimum monthly payments compared to the interest actually charged, or the amount of negative amortization they incurred by paying the minimum payments. The question whether negative amortization was certain to occur with the Option ARM is tied to the amount of interest actually accruing as compared to the minimum payment amounts required under the Note; in particular, the value of and any changes to the indices used to determine the monthly variable interest rate. Was the interest accruing always more than the minimum payment required under the Note? The first amended complaint alleges that the minimum payments "listed in the payment schedules for years 1-3 of the loan term [were] insufficient to pay all of the interest, let alone any of the principal." In our view, that is a factual question, which may require expert testimony, that is not appropriate for resolution at the demurrer stage.[12] Although we do not discuss or decide whether Plaintiffs will be able to prove that

[12] In its demurrer to the first amended complaint, Amnet asked the court to judicially notice that the value of the MTA index in January 2010 was 0.463 percent and argued that if Krumme's index had fallen to this level in the first year of her loan, she would not have incurred any negative amortization. But Amnet's request for judicial notice is not in the record on appeal and the trial court did not rule on the request. We note also that January 2010 was more than four years after Krumme entered into the loan. That Krumme may not have incurred negative amortization in year five of the loan does not necessarily refute the allegation that she was certain to incur some negative amortization. But it does underscore the factual nature of the inquiry.

negative amortization was certain to occur, we conclude that this allegation is sufficient to withstand demurrer.

"Keeping in mind the procedural posture of this case," we hold, as did the court in *Boschma*, that Plaintiffs "have adequately pleaded that material facts were concealed by inaccurate representations and half-truths. If plaintiffs can show defendant intentionally used its Option ARM forms to deceive borrowers, plaintiffs may be able to establish a fraud claim. Plaintiffs' actual interest rates and monthly payments sufficient to amortize the loan (or at least pay the accruing interest) were hidden in the complexity of the Option ARM contract terms. ' "The fact that a false statement may be obviously false to those who are trained and experienced does not change its character, nor take away its power to deceive others less experienced. There is no duty resting upon a citizen to suspect the honesty of those with whom he [or she] transacts business. Laws are made to protect the trusting as well as the suspicious. [T]he rule of *caveat emptor* should not be relied upon to reward fraud and deception." ' " (*Boschma*, *supra*, 198 Cal.App.4th at p. 249, citing *Thompson v. 10,000 RV Sales, Inc*. (2005) 130 Cal.App.4th 950, 976.)

Instead of *Boschma*, Countrywide and Amnet urge us to follow *Taylor*, *supra*, 738 F.Supp.2d 1257, a case from the federal district court for the Northern District of Florida in which the plaintiffs alleged that their Option ARM violated Florida's unfair business practices law because the loan documents failed to adequately disclose that if the borrower made the minimum payments required by the loan, they would be insufficient to cover the interest and negative amortization was certain to occur. (*Id.* at pp. 1259, 1265.) The district court in *Taylor* concluded that the loan documents in that case accurately set forth the possibility of negative amortization and granted the defendant's motion to dismiss. (*Id.* at pp. 1265-1266.) In our view, *Taylor* is distinguishable because the loan documents in that case (the program disclosure in particular) contained much more information than the loan documents here. Taylor's program disclosure mentioned negative amortization at least five times, had a separate, three-paragraph section entitled

"Important Information about Negative Amortization," and stated that the initial minimum payment "may not be sufficient to cover the interest due." It also had an example that explained that for a loan of $10,000 at 7.375 percent interest, the initial payment of $36.96 was less than the amount required to repay principal and interest and that $69.07 per month would be required to amortize the loan. (*Id.* at pp. 1261-1262.)

Moreover, we do not find the other federal cases cited by Countrywide persuasive. *Wallace, supra*, 728 F.Supp.2d 906 is distinguishable procedurally, since it involved a motion for summary judgment. In that case, the district court granted summary judgment on the plaintiff's TILA claim, observing that the Plaintiff had cited no legal authority that supported his claim that the loan disclosures were inadequate under TILA. (*Id.* at p. 917.) But the court denied summary judgment on the state law fraud claims, finding that there were triable issues of fact regarding what the mortgage broker defendant disclosed to the borrower before the loan closed. (*Id.* at p. 923.) In *Conder, supra*, 680 F.Supp.2d at pages 1175–1176, the court held that the plaintiffs' state law fraudulent omissions and UCL claims were preempted by the federal Home Owners Loan Act and did not address the issues presented here. *Chetal v. American Home Mortgage* (N.D.Cal. Aug. 24, 2009, No. C 09-02727 CRB) 2009 U.S. Dist. Lexis 77806 is distinguishable in several respects: procedurally, it involved a motion for a preliminary injunction, which requires a different showing in the trial court than a demurrer; the plaintiff did not plead a fraud cause of action; and in denying the plaintiff's TILA claims, the court observed that the plaintiff did not cite any cases in which similar disclosures had been found inadequate. (*Id.* at pp. *3-*5, *10.)

Second element: Did Defendant have a duty to disclose the allegedly concealed material facts?

Plaintiffs allege that Defendants' "statements in the Loan Documents about the subject of negative amortization (e.g., that it 'may' occur) obligated Defendants to disclose the whole truth, namely, that the subject . . . loans were guaranteed and certain to cause negative amortization to occur (e.g., that negative amortization ‘will’ occur).” Similarly, they allege that Defendants’ statements that the principal amount they may be required to repay could be greater than the amount originally borrowed and that the amount of the monthly payment could be less that the amount of interest accruing obligated Defendant to disclose the whole truth, namely that their principal “balances, with 100% certainty, would be greater” and that the monthly payments would always be less than the interest actually due.

In support of these propositions, the first amended complaint cites and relies on the following from *Randi W. v. Muroc Joint Unified School Dist.* (1997) 14 Cal.4th 1066, 1082 (*Randi W.*): “we view this case as ‘a misleading half-truths’ situation in which defendants, having undertaken to provide some information . . . were obliged to disclose all other facts which ‘materially qualified’ the limited facts disclosed” and *Vega v. Jones, Day, Reavis & Pogue* (2004) 121 Cal.App.4th 282, 292: “ ‘where one does speak he must speak the whole truth to the end that he does not conceal any facts which materially qualify those stated . . . . [T]the telling of a half-truth calculated to deceive is fraud.’ ” As the court stated in *Boschma*, Defendants “had a common law duty to avoid making partial, misleading representations that effectively concealed material facts.” (*Boschma*, *supra*, 198 Cal.App.4th at p. 250, citing *Randi W.*, at pp. 1082–1084 & *LiMandri v. Judkins* (1997) 52 Cal.App.4th 326, 336 (*LiMandri*).) We conclude that these allegations were sufficient to state the duty-to-disclose element of the cause of action for fraudulent concealment.

Third element: Did Plaintiffs adequately plead an intent to defraud?

Plaintiffs allege that “Defendants purposefully and intentionally devised this Option ARM loan scheme of stating only partially true facts and omitting important material information . . . to deceive consumers into believing that these loans would provide a low-interest rate for the first several years of the loan term and that, if they made their payments according to the payment schedule provided by Defendants, this would be sufficient to pay both principal and interest." In support of their claim that Defendants acted with an intent to defraud, Plaintiffs assert that "Defendants knew or should have known that the loans were guaranteed to result in negative amortization, because Defendants accrued the negative amortization as income for accounting and/or tax purposes" and included the deferred interest in their calculations of the total finance charges payable over the life of the loans for the TILDS statements. Moreover, they alleged that Countrywide described Option ARM loans as "negative amortization mortgage loans" in a 2007 prospectus for the sale of mortgage-backed securities, told prospective investors that negative amortization was certain to occur, and "protect[ed] its own bottom line from the increased risk of borrower default that negative amortization created" by selling the loans in the secondary market. They also assert that the prepayment penalties "purposefully and intentionally made it extremely difficult, if not impossible, for Plaintiffs . . . to extricate themselves from the" loans. In our view, these allegations were sufficient to state the intent element of a cause of action for fraudulent concealment.

Fourth element: Did Plaintiffs plead reliance?

The plaintiff in a fraudulent omission case establishes reliance by pleading and proving that "had the omitted information been disclosed, [the plaintiff] would have been aware of it and behaved differently." (*Mirkin v. Wasserman* (1993) 5 Cal.4th 1082, 1093 (*Mirkin*).) " 'It is not . . . necessary that [a plaintiff's] reliance upon the truth of the fraudulent misrepresentation be the sole or even the predominant or decisive factor in influencing his conduct. . . . It is enough that the representation has played a substantial part, and so has been a substantial factor, in influencing his decision.' " (*Engalla v. Permanente Medical Group, Inc*. (1997) 15 Cal.4th 951, 976-977.)

Plaintiffs have alleged that if Defendants had disclosed that their initial interest rate was a teaser rate and that negative amortization was certain to occur if they made the minimum payments shown on the payment schedule, they would not have entered into the loans. These allegations were sufficient to state the reliance element of the cause of action.

As the court stated in *Boschma*, "it would be improper to adjudicate the factual question of [P]laintiffs' actual reliance at the demurrer stage. Moreover, given our analysis of the loan documents, we reject the contention that the disclosures actually given to [P]laintiffs preclude reasonable reliance." (*Boschma, supra*, 198 Cal.App.4th at p. 251, fn. omitted, citing *Ralston II*, *supra*, 2010 WL 3211931, pp. *5–*6 [rejecting argument that plaintiff could not prove reliance because of the contents of the loan documents] & *Alliance Mortgage Co. v. Rothwell* (1995) 10 Cal.4th 1226, 1239 [whether reliance was reasonable is usually a question of fact].)

In a footnote, *Boschma* expressed reservations about the plaintiffs' ability to prove reliance. We think these points bear repeating: "[T]he mere fact that borrowers took out Option ARM's does not necessarily prove they were misled by disclosures. Borrowers who understood the terms of the loan may still have agreed to the loan because it enabled them to buy now and pay later. Some borrowers may have speculated that real estate prices would continue to climb, enabling them to refinance after the initial low payment period ended. Others may have speculated that they would have more income in a few years and that they needed to buy a home before they were "priced out" of the market. And still others may have utilized Option ARM's to facilitate non-housing-related consumer spending or to finance small businesses. This highlights the difference between disclosure policy concerns (i.e., does the consumer understand the credit product) and more paternalistic policy concerns as to whether consumers should be allowed to take on the risk of an Option ARM." (*Boschma*, *supra*, 198 Cal.App.4th at p. 251, fn. 11.)

Fifth element: Did Plaintiffs adequately plead damages

We agree with *Boschma* that "Plaintiffs' theory of damages (lost home equity) is problematic. Every month in which [P]laintiffs suffered negative amortization was a month in which they enjoyed payments lower than the amount needed to amortize the loan (or even to pay off the accruing interest). In exchange for gradually declining equity, plaintiffs retained liquid cash that they otherwise would have paid to [Defendants] (or another lender)." (*Boschma, supra*, 198 Cal.App.4th at p. 251.) Moreover, it may be difficult for Plaintiffs to prove they could not have avoided the alleged harm of negative amortization by simply paying more each month after they discovered their minimum payment was not sufficient to pay off the interest accruing on the loan. (*Id.* at pp. 253-254.) But we also agree that Plaintiffs' "allegation of lost equity in their homes is sufficient at this stage of the proceedings to overrule [the] demurrer[s]. We construe [P]laintiffs' allegations (including the allegation that the prepayment penalty precluded refinancing into a better loan) broadly to encompass an assertion that they were misled into agreeing to Option ARM's, which led to lost equity in their homes because the terms of the Option ARM's put them in a worse economic position than they would have been had they utilized a different credit product . . . ." (*Id.* at p. 251.)

Section 17200

California's UCL "does not proscribe specific activities, but broadly prohibits 'any unlawful, unfair or fraudulent business act or practice and unfair, deceptive, untrue or misleading advertising.' (§ 17200.) The UCL 'governs "anti-competitive business practices" as well as injuries to consumers, and has as a major purpose "the preservation of fair business competition." [Citations.] By proscribing "any unlawful" business practice, "section 17200 'borrows' violations of other laws and treats them as unlawful practices" that the unfair competition law makes independently actionable.' [Citation.] ' "Because . . . section 17200 is written in the disjunctive, it establishes three varieties of unfair competition—acts or practices which are unlawful, or unfair, or fraudulent. 'In other words, a practice is prohibited as "unfair" or "deceptive" even if not "unlawful" and vice versa.' " ' " (*Puentes v. Wells Fargo Home Mortgage, Inc.* (2008) 160 Cal.App.4th 638, 643–644.)

“ ‘[A] practice may be deemed unfair even if not specifically proscribed by some other law.’ ” (*Korea Supply Co. v. Lockheed Martin Corp*. (2003) 29 Cal.4th 1134, 1143.) As the *Boschma* court explained, “According to some appellate courts, a business practice is ‘unfair’ under the UCL if (1) the consumer injury is substantial; (2) the injury is not outweighed by any countervailing benefits to consumers or competition; and (3) the injury could not reasonably have been avoided by consumers themselves. (*Camacho v. Automobile Club of Southern California* (2006) 142 Cal.App.4th 1394, 1403–1405.) Other courts require ‘that the public policy which is a predicate to a consumer unfair competition action under the ‘unfair’ prong of the UCL . . . be tethered to specific constitutional, statutory, or regulatory provisions.’ (*Bardin v. DaimlerChrysler Corp*. (2006) 136 Cal.App.4th 1255, 1260–1261.) Still others assess whether the practice ‘is immoral, unethical, oppressive, unscrupulous or substantially injurious to consumers . . . [weighing] the utility of the defendant’s conduct against the gravity of the harm to the alleged victim.’ (*Id*. at p. 1260.) And some courts, in reviewing a pleading, apply all three tests. (*Drum v. San Fernando Valley Bar Assn*. (2010) 182 Cal.App.4th 247, 256–257.)” (*Boschma*, *supra*, 198 Cal.App.4th at p. 252.)

“[A] fraudulent business practice is one that is likely to deceive members of the public.” (*Morgan v. AT&T Wireless Services, Inc*. (2009) 177 Cal.App.4th 1235, 1255.) “A claim based upon the fraudulent business practice prong of the UCL is ‘distinct from common law fraud. “A [common law] fraudulent deception must be actually false, known to be false by the perpetrator and reasonably relied upon by a victim who incurs damages. None of these elements are required to state a claim for . . . relief” under the UCL. [Citations.] This distinction reflects the UCL’s focus on the defendant’s conduct, rather than the plaintiff’s damages, in service of the statute’s larger purpose of protecting the general public against unscrupulous business practices.’ ” (*Ibid*.) A fraudulent business practice “ ‘ “may be accurate on some level, but will nonetheless tend to mislead or deceive. . . . A perfectly true statement couched in such a manner that it is likely to mislead or deceive the consumer, such as by failure to disclose other relevant information, is actionable under" ' the UCL." (*McKell v. Washington Mutual, Inc.* (2006) 142 Cal.App.4th 1457, 1471 (*McKell*).)

Plaintiffs' section 17200 claim relies on the concept of fraud. Although the first amended complaint alleges "unlawful" behavior, the only statutes specifically cited are Civil Code sections 1572 (actual fraud—omissions) and 1710 ([definition of] deceit). Plaintiffs also cite some of the cases we mentioned previously, including *LiMandri*, *Randi W.*, and *Mirkin*. The determination whether a practice is fraudulent or unfair under the UCL is one of fact, which generally cannot be determined on demurrer. (*McKell*, *supra*, 142 Cal.App.4th at p. 1473.) Based on our analysis of Plaintiffs' common law fraud claim, we conclude that Plaintiffs have adequately pleaded a section 17200 claim under the unlawful and fraudulent prongs.

Although Plaintiffs' UCL claim under the unlawful prong may be duplicative of their common law fraud cause of action (unlike the "fraudulent" prong claim, which is easier to prove in the § 17200 context), there are separate remedies for fraud and section 17200 claims. We see no reason to force Plaintiffs to select between the two causes of action at this stage of the proceedings. (*Boschma*, *supra*, 198 Cal.App.4th at p. 253, fn. 12.)

The *Boschma* court observed that the plaintiffs "unfair" allegations in that case, as in ours, focused on the same allegedly misleading disclosures in the loan documents and concluded that the "plaintiffs [had] adequately pleaded that Option ARM loans with conditional disclosures with regard to negative amortization were 'unfair' under the UCL: 'Plaintiffs have sufficiently alleged that they did not discover the certainty of negative amortization until they were "locked in" with a harsh prepayment penalty under the terms of the agreement. They allege that the loan documents do not clearly specify the certainty of negative amortization. . . . Additionally, the payment schedule does not clearly indicate it is based upon the teaser rate rather than the APR listed on the top of the page. Thus, plaintiffs have sufficiently alleged that an ordinary consumer relying on the plain language of the loan agreement might not have been able to avoid the injury of negative amortization because they did not understand it was certain to occur.' " (*Boschma*, *supra*, 198 Cal.App.4th at p. 253, quoting *Jordan*, *supra*, 745 F.Supp.2d at p. 1100.) We agree.

Plaintiffs also argue that the loans were unfair because Defendants failed to disclose what their various payment options were before they entered into the loans. All three Notes mentioned a "Full Payment" and the "Minimum Payment" in paragraphs 3(D). And paragraph 3(H) of the Notes provides that the lender "may" provide "up to" three additional payment options from a list, including an "Interest Only Payment," a "Fully Amortized Payment," and a "15[-]Year Amortized Payment." The program disclosures are all different with regard to the disclosure of payment options. Perez's disclosure did not mention payment options; Krumme's program disclosure stated that the lender may provide "other monthly payment options" but did not describe the options; and Thibault's program disclosure advised that he "may have up to 3 additional payment options," and briefly described "Interest Only," "Amortized Payment," and "15[-]Year Amortized Payment" options without listing any dollar amounts. Although the loan documents contain varying disclosures regarding the payment options, Plaintiffs argue that they were misleading and unfair because they failed to disclose the "drastically higher dollar amounts" of those options "prior to closing." Since we conclude that Plaintiffs are able to state cause of action based on allegedly unfair business practices based on the failure to disclose the alleged certainty of negative amortization, we shall not reach the question whether the failure to disclose all of the payment options prior to the closing of the loans provides a second factual basis for the claim.

As the court stated in *Boschma*, "it may be difficult for [P]laintiffs to prove they could not have avoided *any* of the harm of negative amortization—they could have simply paid more each month once they discovered their required [payments were] not sufficient to pay off the interest accruing on the loan[s]. But [P]laintiffs may [be able to] show they were unable to avoid some substantial negative amortization. And we see no countervailing value in [Defendants'] practice of providing general, byzantine descriptions of Option ARM's, with no clear disclosures explaining that . . . negative amortization would certainly occur if payments were made according to the payment schedule. To the contrary, a compelling argument can be made that lenders should be discouraged from competing by offering misleading teaser rates and low scheduled initial payments (rather than competing with regard to low effective interest rates, low fees, and economically sustainable payment schedules). Finally, to the extent an 'unfair' claim must be 'tethered' to specific statutory or regulatory provisions, TILA and Regulation Z provide an adequate tether even though plaintiffs are not directly relying on federal law to make their claims." (*Boschma*, *supra*, 198 Cal.App.4th at pp. 253-254.)

Defendants argue that Plaintiffs have not adequately alleged reliance under the UCL. (See *In re Tobacco II Cases* (2009) 46 Cal.4th 298, 325–326 [UCL claimant must show reliance when alleged misrepresentations are basis for claim].) For the reasons stated above in the fraudulent omissions section, we disagree.

Defendants also assert that Plaintiffs have not adequately alleged standing under the UCL. (Bus. & Prof. Code, § 17204 [private plaintiff must have "suffered injury in fact and . . . lost money or property as a result of the unfair competition"].) "At the pleading stage, a UCL plaintiff satisfies its burden of demonstrating standing by alleging an economic injury." (*Boschma*, *supra*, 198 Cal.App.4th at p. 254, citing *Kwikset Corp. v. Superior Court* (2011) 51 Cal.4th 310, 323–325.) Plaintiffs' allegations of negative amortization/lost equity represent an economic injury.

Arguments Regarding Countrywide Financial

Countrywide Financial Corporation (CFC) argues that there are independent reasons the court properly sustained the demurrer as to it.

Citing an SEC filing attached to its request for judicial notice in the trial court, CFC argues that it is a bank holding company that did not itself make, sell or service any loans. While the trial court and this court may properly judicially notice the fact that CFC filed this document with the SEC, we may not judicially notice the truth of hearsay statements contained within the document. (Evid. Code, §§ 452, subd. (h), 459; *Williams v. Wraxall* (1995) 33 Cal.App.4th 120, 130, fn. 7.) Since the factual basis for CFC's argument cannot be properly judicially noticed, the SEC filing cannot be used to contradict the allegations of the first amended complaint. The first amended complaint alleges that CFC and Countrywide Home Loans (CHL) were in the business of securitizing homes loans to sell to investors and operated jointly as a single enterprise in connection with the events described in the complaint, facts which we accept as true in this proceeding.

CFC argues that Plaintiffs do not allege that it made any representations to any of the Plaintiffs and that without such allegations, Plaintiffs cannot state a cause of action against CFC. But the first amended complaint alleges that CFC was the parent company to CHL and that the Countrywide defendants jointly engaged in a scheme to sell fraudulent Option ARM loans, which they subsequently pooled and sold in secondary mortgage transactions. In light of these allegations, we reject Countrywide's assertion that CFC is separately entitled to a dismissal.

Conclusion

We have carefully reviewed the first amended complaint and applied the standard of review that applies to an order sustaining a demurrer without leave to amend. We conclude, as the court did in *Boschma*, that the first amended complaint adequately alleges causes of action for fraud and violations of section 17200 et seq. We express no views on the merits of the Plaintiffs' causes of action.

DISPOSITION

The judgment is reversed. The trial court is directed to overrule Defendants' demurrers to the first amended complaint. Plaintiffs shall recover costs on appeal.

____
BAMATTRE-MANOUKIAN, ACTING P.J.

WE CONCUR:

____
MIHARA, J.

____
DUFFY, J.[*]

[*]Retired Associate Justice of the Court of Appeal, Sixth Appellate District, assigned by the Chief Justice pursuant to article VI, section 6 of the California Constitution.