

I. SUMMARY OF MAJOR TOPICS

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II. TRUTH IN LENDING ACT DEVELOPMENTS

- A. Availability of Class Actions for Rescission. Under TILA, 15 U.S.C. § 1640, allows class actions for damages, while the rescission provisions are silent. In just the last few months, a number of courts have addressed whether or not this silence precludes class certification for rescission claims.
 - 1. In *McKenna v. First Horizon Home Loan Corp.*, 2007 WL 210850 (1st Cir. (D. Mass) January 29, 2007), the First Circuit held that class-wide rescission claims, whether sought directly for the class or as declaratory right at the election of a class of borrowers, are not available under TILA.
 - a. In March 2004, plaintiffs sued First Horizon Home Loan Corporation, alleging that First Horizon had violated TILA and the Massachusetts Consumer Credit Cost Disclosure Act by inaccurately disclosing information relating to consumers' statutory rescission rights and, subsequently, had failed to respond appropriately to requests for the rescission of residential refinancings. The borrowers claimed that these violations entitled them to rescission of their loans and statutory damages. Plaintiffs likewise asked the court to declare that any class member could likewise elect to rescind his or her credit transaction with First Horizon at any time during the extended 3-year statutory default period. The trial court certified a class, and First Horizon appealed the class certification order.

- b. In a matter of first impression, the First Circuit held that class certification was not available for rescission claims, whether of a direct or declaratory nature, under TILA (and, thus, under MCCCDA). The Court, after examining the statute and legislative history, concluded that Congress did not intend rescission suits to receive class action treatment. The First Circuit pointed out:
 - i. That while TILA addresses class actions in its damages provisions, there is no comparable mention of the class action mechanism in the rescission section
 - ii. That rescission was, by its nature, a personal remedy. The highly individualized character of the rescission process, and the range of variations that may occur made rescission generally incompatible with the class action process.
2. In *LaLiberte v. Pacific Mercantile Bank*, 2007 WL 188882 (Cal. App. January 25, 2007), the California Court of Appeal likewise concluded that borrowers are not entitled to pursue rescission class actions.
3. But, in *Andrews v. Chevy Chase Bank, FSB*, 2007 WL 112568 (E.D. Wis. January 16, 2007), the court ruled that Chevy Chase's failure to clearly and conspicuously disclose the payment period, annual percentage rate and variable interest rate feature, which all involved material disclosures, rendered Chevy Chase liable for rescission. More troubling for Chevy Chase, the court likewise granted the borrowers' motion for class certification, and concluded that TILA allows class actions "to obtain a judicial determination whether an infirmity in the documents, common to all members of the class, entitles each member of the class individually to seek rescission." The case has been appealed to the Seventh Circuit.

B. May post-closing events render previously accurate TILA disclosures inaccurate?

1. Reg. Z § 226.17(e) provides: "Effect of subsequent events. If a disclosure becomes inaccurate because of an event that occurs after the creditor delivers the required disclosures, the inaccuracy is not a violation of this regulation, although new disclosures may be required under section (f) of this section, § 226.19, or § 226.20."
2. In *Vician v. Wells Fargo Home Mortgage*, 2006 WL 694740 (N.D. Ind. Mar. 16, 2006), the lender force placed hazard insurance in contravention of a rider in the loan documents. Notwithstanding that the TILA disclosures were accurate when made, the court concluded that this action triggered a TILA violation because Wells Fargo failed to accurately disclose the loan balances. Since the borrower may be able to demonstrate that new disclosures were required, the court denied a motion to dismiss.

3. But, in *Caddell v. CitiMortgage, Inc.*, 59 UCC Rep. Serv. 2d 181 (D. Kan. Feb. 14, 2006), the court concluded that CitiMortgage’s misapplication of prepayment penalties did not skew the effective interest rate so as to render the TILA disclosures inaccurate. CitiMortgage was granted summary judgment.
- C. Is the rescission remedy available after the borrowers pays off the loan? (In other words, is there such a thing as “rescission damages” in lieu of rescission itself?)
1. In *Handy v. Anchor Mortgage Corp.*, 464 F.3d 760 (7th Cir. 2006), the Seventh Circuit answers this question in the affirmative. In this case, the lender used two different forms for notice of right to cancel (using both the Reg. Z H-9 and Reg.Z H-8 forms in the same transaction). Anchor argued that the forms were substantially similar and its use of both forms was a bona fide error. Reversing the lender’s victory at the district court level, the Seventh Circuit concluded: (1) that the two forms, read together, created an ambiguity; and (2) that the right of rescission is not cut off by payoff of the loan.
 2. Likewise, in *Barrett v. JP Morgan Chase Bank, N.A.*, 2006 WL 997231 (6th Cir. Apr. 18, 2006), the Sixth Circuit ruled that a refinancing does not extinguish the right to rescind. The court concluded that there is more to rescission than a return to *status quo ante*: “the right to rescind a transaction under the Act not only gives consumers the right to release the security interest in their home but also gives them the right to recover fees in the transaction.”
- D. Miscellaneous rulings concerning disclosure obligations
1. All TILA disclosures must be made by the creditor (rather than its designee), Third Circuit declares. In *Vallies v. Sky Bank*, 432 F.3d 493 (3d Cir. 2006), a putative class action, plaintiff alleged that Sky Bank violated TILA in connection with an auto loan obtained in connection with an auto purchase from a car dealer. Reversing the district court, the Third Circuit rejected the contention that disclosure obligations could be delegated to or satisfied by the dealer.
 2. TILA does not require disclosure of the method for calculating interest. In *Haynes v. HomEq Servicing Corp.*, 2006 WL 2167375 (M.D. Tenn. Aug. 1, 2006), the court refused to graft a requirement that the finance charge disclosure include a description of methodology used in calculating interest.

III. FAIR CREDIT REPORTING ACT DEVELOPMENTS: FIRM OFFERS OF CREDIT AND ADVERSE ACTION CLAIMS

- A. The Fair Credit Reporting Act, 15 U.S.C. § 1681 *et seq.* (“FCRA”), was enacted to ensure that credit bureaus (consumer reporting agencies, or “CRA’s”) such as

Experian, Equifax and Trans Union protect the privacy of the consumer information they obtained.

- B. There have been three major developments in FCRA litigation since the last update:
1. The Supreme Court is expected to resolve a split among the federal circuits on the standard for proving “willfulness” under the statute;
 2. Based on legislative amendments enacted in 2003, and effective December 1, 2004, the courts – based on several rulings in 2006 -- have now widely declared that there is no longer a private right of action for violation of the “adverse action” notice requirements, or “clear and conspicuous” disclosure requirements of FCRA; and
 3. In recent Seventh Circuit and district court decisions, the courts are beginning to provide a more balanced perspective on what constitutes a proper “firm offer of credit” under the statute.
- C. *Top story*: The United States Supreme Court prepares to issue its ruling in *Safeco* and *GEICO*. In those cases, the Court is likely to resolve a split among appellate circuits on the interpretation of Section 1681n’s “willful noncompliance” provision. If the Supreme Court adopts the Ninth Circuit’s current standard, it will adversely impact all present and future FCRA litigation, because plaintiffs would be able to obtain statutory and punitive damages as long as they could show that a defendant acted in reckless disregard of the FCRA’s requirements. There are two components to the *Safeco/GEICO* litigation:
1. Under the FCRA, a creditor or insurer must provide an “adverse action notice” when negative information in the consumer’s credit report adversely affected the quoted price.
 2. On January 16, 2007, the Court heard arguments in the consolidated cases of *GEICO General Insurance Company v. Edo*, No. 06-100, and *Safeco Insurance Company v. Burr et al.*, No. 06-84. These decisions follow (and seek certiorari to) the Ninth Circuit’s controversial ruling in *Reynolds v. Hartford Financial Services*, 435 F.3d 1081 (9th Cir. 2006). The Court’s ruling is expected as early as next month (June 2007).
- D. *Safeco/GEICO* should resolve two critical issues arising under FCRA: (i) whether a “willful” violation of the statute occurs when the violation is based on a mere reckless disregard for the law or whether such violation must be intentional; and (ii) whether the Ninth Circuit improperly interpreted the “adverse action notice” rules to require such notices in all cases in which the consumer fails to qualify for the company’s best available rate, even if the credit history has no negative effect on the quoted price.
- E. The insurers contend that there is no “adverse action” notice requirement because the companies did not increase the quoted insurance prices based on negative

information in his credit report, and therefore they had no duty under the FCRA to provide such a notice.

- F. In *Reynolds* (and its related cases), the Ninth Circuit held that FCRA requires adverse action notices any time an insurer, after considering the credit report of a consumer, sets a premium rate higher than the company's lowest possible rate. Moreover, if a consumer sues the insurer for a willful FCRA violation, he need only show proof of reckless disregard of the FCRA's requirements. Safeco's and GEICO's legal positions on the adverse action issue were deemed so "indefensible" and "implausible" that there was, at best, a triable issue as to whether this constituted willfulness under the Court's "reckless disregard" standard.
- G. The more critical issue before the Court is whether the Ninth Circuit's erred in its liberal reading of the "willfulness" provisions of FCRA. The *Reynolds* ruling conflicts with the "willfulness" standard adopted by several other Circuits, including the Seventh and Eighth Circuits. See, e.g., *Phillips v. Grendahl*, 312 F.3d 357, 368 (8th Cir. 2002) ("willfully" imports the "requirement that defendant know his or her conduct is unlawful"); *Wantz v. Experian Information Solutions, Inc.*, 386 F.3d 829, 834 (7th Cir. 2004) (requiring plaintiff to prove that defendant "knowingly and intentionally violate [the law].").
- H. In their briefs, *GEICO* and *Safeco* contended – consistent with the rulings from other Circuits -- that "willfulness" requires an intentional violation of a known legal duty. In contrast, respondents asserted that the Ninth Circuit's definition is consistent with the statute and its context, including a policy or action carried out either knowing that policy or action to be in contravention of a consumer's rights under the FCRA or in reckless disregard of whether the policy or action contravened those rights. They further asserted that the Ninth Circuit's analysis tracks the Supreme Court's precedents dating back to at least the 1930s. Since that time, they argued, the Supreme Court has consistently concluded that "willful" violations of similar civil statutes include conduct committed in reckless disregard of others.
- I. "Firm offer of credit" litigation developments since *Cole v. U.S. Capital*, 389 F.3d 719 (7th Cir. 2004).
 - 1. Under FCRA, a consumer's credit report may be obtained from a CRA only with the written consent of the consumer or for certain "permissible purposes." One such permissible purpose is for a transaction that consists of a firm offer of credit. 15 U.S.C. § 1681a(l). A firm offer is "[a]ny offer of credit or insurance to a consumer that will be honored if the consumer is determined, based on information in a consumer report on the consumer, to meet the specific criteria used to select the consumer for the offer..." *Id.*

2. In *Cole*, the Seventh Circuit looked beyond the statute and held, in relevant part, that “firm offers” must further have sufficient value to justify the invasion of privacy. The court reversed a dismissal of plaintiff’s cause of action because the firm offer mailed lacked sufficient material terms for the court to determine, at the motion to dismiss phase, whether the offer met “firm offer” value requirements. The court concluded that, when an offer technically complies with the statute but nevertheless is a “guise for solicitation rather than a legitimate credit product, the communication cannot be considered a firm offer of credit.” *Id.* at 728. Further, the *Cole* court directed courts to look at the entire offer and effect of all material conditions. *Id.* at 726-27. The consumer advocate’s bar read *Cole* to graft a requirement that all material terms be included in the initial mailer, and a number of lower courts appeared to agree.
3. In *Murray v. GMAC Mortgage Corp.*, 434 F.3d 948, 955 (7th Cir. 2006), the Seventh Circuit further amplified on its ruling in *Cole*, holding that a “sham offer used to pitch a product rather than extend credit does not meet” FCRA requirements. Further, the court rather ambiguously stated as follows: “To decide whether [defendant] has adhered to the statute, a court need only determine whether the four corners of the offer satisfy the statutory definition (as elaborated in *Cole*), and whether the terms are honored when consumers accept.” *Id.* at 956. Did the court mean to suggest that the firm offer mailer was equivalent to the transaction itself? And was the Seventh Circuit suggesting that statutorily-allowed post-screening was no longer a consideration? Over the course of several months, district courts debated the meaning of the ruling.
4. In the second half of 2006, however, the Seventh Circuit clarified its *Cole* ruling yet again in *Perry v. First National Bank*, 489 F.3d 816 (7th Cir. 2006). In *Perry*, the court affirmed the dismissal of a credit card firm offer lawsuit because the offer met *Cole* criteria. The Seventh Circuit concluded, among other things, that a “firm offer” need not convey “an attractive deal for the great majority of consumers” for it to have value. *Id.* at 825. Further, the court distilled *Cole* into three requirements: (1) whether it appears likely that the offer would be honored; (2) whether the terms of the offer are adequately disclosed; and (3) whether the amount of credit being offered is so minimal or subject to so many limitations that it is of little value. *Id.* at 825.
5. In *Perry*, the Seventh Circuit likewise addressed the question whether Congress, in passing certain legislation in 2006, eliminated a private right of action for violations of 15 U.S.C. § 1681m, which addresses claims for “clear and conspicuous” disclosure obligations and (not immaterially) claims for violation of the adverse action notice requirements.

6. In 2003, Congress passed the Fair and Accurate Credit Transactions Act (“FACTA”). As part of the enactment, Congress added a new subsection, 15 U.S.C. § 1681m(h)(8)(A), which provides that “Sections 1681n [causes of action for willful noncompliance] and 1681o [causes of action for negligent noncompliance] of this title shall not apply to any failure by any person to comply with *this section*.” Consumer advocates argued that the provision addressed just Section 1681m(h) claims, and that any broader reading was, at worst, a scrivener’s error, since Congress never intended to eliminate private rights of action for all claims under Section 1681m.
7. In *Perry*, the Seventh Circuit sided with the defense. The court held that the FACTA amendment effectively eliminated a private right of action to enforce any violation of Section 1681m, including alleged adverse action violations. *Id.* at 823. Private rights of action under other parts of the FCRA were not affected by FACTA.
8. In a major victory for lenders, a district court in Indiana concluded, on cross-motions for summary judgment, that a lender did not willfully violate FCRA in connection with a noncompliant “firm offer” mailer. In *Bruce v. KeyBank N.A.*, 2006 U.S. Dist. Lexis 91371 (N.D. Ind. Dec. 15, 2006), the court followed Seventh Circuit precedent that, for a party to willfully violate FCRA, a party must “knowingly and intentionally violate [the FCRA], and it ‘must also be conscious that [its] act impinges on the rights of others.’” *Id.* at *14, quoting *Ruffin-Thompkins v. Experian Info. Systems, Inc.*, 422 F.3d 603, 610 (7th Cir. 2005). The evidence established a compliance procedure, including review and approval by an experienced compliance officer. No evidence was adduced that KeyBank personnel were aware of any requirement that all material terms be included in the mailer. As the court concluded: “Ultimately, there is no smoking gun in this case; that is, there is no direct evidence of Defendant or any of its agents admitting that it knowingly and intentionally violated the FCRA and that it was conscious that its acts impinged on the rights of others.” *Id.* at *18. The court granted summary judgment to KeyBank.
9. Of equal importance, another district court, in *Cavin v. Home Loan Center, Inc.*, 469 F. Supp. 561 (N.D. Ill. 2007), concluded that, despite *Cole* and its progeny, a firm offer mailer need not include every material term to satisfy FCRA. Said the court: “we do not read *Cole* or *Perry* to require disclosure of every single loan term for an offer to be considered firm. Such a requirement poses particular difficulty in the case of a mortgage, because unlike a credit card, a mortgage is tailored to the individual consumer depending on such factors as how much he or she wishes to borrow, his or her current income, and the value of the property offered as collateral; all of this information would have to be provided [after the mailer was received] by the individual borrower.” *Id.* at 569, citing *Murray v. HSBC Auto Finance, Inc.*, 2006 U.S. Dist. Lexis 74128 (N.D. Ill. Sept. 27, 2006).

10. Based on recent rulings, risks remain. Plaintiffs continue to file suit, alleging willful violations of FCRA in connection with prescreened mailings. If the U.S. Supreme Court favorably resolves the split among Circuits, or if regulatory agencies step in and clarify that “firm offer” mailers need not include every material term, this could lead to a major resolution of the litigation.

IV. RESPA

- A. Test case holds that flat-fee pricing does not violate RESPA Section 8(a).
 1. *Price v. Landsafe Credit, Inc.*, 2006 WL 3791391 (S. D. Ga. Dec. 22, 2006): The Court granted summary judgment for defendants, holding that Section 8(a) does not prohibit companies from adopting a flat-fee pricing structure to recoup expenses of credit reports. The arrangement challenged in this action was that the lender was not charged by its affiliated title company for credit reports for potential consumers that did not result in loans. The lender was instead charged a flat rate (\$35) for pulling credit for a loan applicant that led to issuance of a loan, regardless of how many times the affiliate had to run the credit report. The plaintiffs contended that the “free” credit reports for non-borrowers constituted an illegal kickback under RESPA. The court rejected this argument, holding that the business charge for overhead – including the cost of investigating potential borrowers’ credit – was legitimate. The court compared the charge to charges for mortgage insurance – a service that does not benefit borrowers directly. The court considered its decision to be consistent with a prior Ninth Circuit holding regarding the reasonableness of flat-fee price structures. *See Lane v. Residential Funding Corp.*, 323 F.3d 739 (9th Cir. 2003).
 2. The plaintiffs in *Price* have appealed to the Eleventh Circuit, where briefing is complete. In the interim, similar suits are cropping up in other jurisdictions. How the Eleventh Circuit resolves the appeal may dictate how many additional attempts there may be to seek recovery under this theory and whether the industry will face another circuit split.
 3. MBA has proposed a revision to RESPA that would expressly permit average-cost pricing.
- B. Excessive Fee Claims
 1. What is a split? The Circuit Courts remain divided as to whether more than one actor is required under RESPA Section 8(b) to “split” a markup. Unless and until the Supreme Court takes up the issue or Congress acts, the plaintiffs’ bar will continue to forum shop to avoid unfavorable jurisdictions.

2. *Wooley v. Countrywide Home Loans, Inc.*, No. 06-835 (S.D. Ala. filed Dec. 2006), was filed as a class action against the originating lender, assignee lender, the closing agent, and the title company. The plaintiffs assert, inter alia, that the title insurance premium that they were charged exceeded the maximum allowed by the Alabama Department of Insurance, and that the premium was marked up and split by the closing agent and the title insurer, in violation of RESPA. The plaintiffs further contend that the Truth-in-Lending disclosure provided by the lender violated the act by failing to include the amount of the title insurance premium, and that both the lender and the assignee of the loan are liable for the violation. In March 2007 the court granted a joint motion to dismiss the lawsuit without prejudice.
 - a. Reissue Rate Litigation: Similarly, there are a number of pending cases testing out a new RESPA theory based on the alleged failure of title insurers to offer discounted reissue rates for owner's title insurance and then splitting the premiums with the insurance producers. The plaintiffs in those cases have had varying degrees of success on summary judgment and motions to dismiss. *E.g. Jackson v. The Security Title Guarantee Corp. of Baltimore*, No. 06-2639 (D. Md. filed Oct. 6, 2006) (settlement pending according to docket); *Mitchell-Tracey v. United General Title Insurance Co.*, No. 05-1428 (D. Md. filed May 24, 2005) (summary judgment granted for defendants on RESPA claim Sept. 2007; class certified on state-law claims).
3. In *Lemley v. Liberty Title Insurance Company, LLC*, No. 06-2076 (N.D. Ala. filed Oct. 2006), the named plaintiffs filed a class action complaint against a settlement agent and a title insurer, alleging that they marked up third party settlement service costs in violation of RESPA. Specifically, the plaintiffs assert that they were charged (a) amounts for a title search, title examination, and recording costs that exceeded the actual third-party costs, and (b) an amount for title insurance that exceeded the rate approved by the Alabama Department of Insurance. The parties are currently conducting discovery.

C. YSP: How much disclosure is required?

1. Recent litigation challenges YSP range disclosures as violative of RESPA. At least one court has suggested that the analysis of whether there is a violation under RESPA Section 5(c) (12 U.S.C. § 2404(c)) turns on whether the range was provided in good faith.
2. HUD previously considered promulgating a regulation that would make certain changes to Section 5(c). In the proposal, which was later withdrawn, HUD noted that, under the current rule, a YSP range was an

acceptable disclosure. RESPA Proposed Rule, 67 Fed. Reg. 49,134-10, 49,140 (July 29, 2002).

3. Note: California requires that the YSP disclosure state a specific dollar amount as the YSP estimate.

D. RESPA Claims in Disguise

1. The RESPA one-year statute of limitations, the lack of a private right of action as to certain claims under RESPA, and efforts to avoid litigating in federal court have led to “creative” litigation.
2. A novel putative class action filed in Minnesota in February 2007 attempts to stretch the disclosure requirements beyond RESPA, based on the theory of fiduciary duty. *Grady v. Burnet Realty Inc. dba Coldwell Banker Burnet* (4th Jud. District Minn.).
 - a. The named plaintiffs assert that the real estate brokerage company that they retained in connection with their purchase of a residence referred them to its affiliate for title insurance and closing services. The plaintiffs contend, on behalf of the putative class, that they paid affiliate fees and premiums for title insurance and services that were higher than – if not the highest among – the fees charged by other providers in the same market for the same or comparable services. The plaintiffs further allege that the broker knew that there were lower priced alternatives to the affiliate for the same or comparable goods and services, but the broker did not disclose these “material facts” to the plaintiffs. Similarly, the plaintiffs allege that the broker pressured its associates to steer clients to the affiliated title company and provided financial incentives in that regard.
 - b. Even though the plaintiffs concede that the broker provided to them a RESPA-compliant Affiliated Business Disclosure, which informed the borrowers of their right to shop around for other providers of settlement services, the plaintiffs contend that more is required. Specifically, the plaintiffs assert that the relationship between the broker and its clients is subject to a fiduciary duty. According to the plaintiffs, that fiduciary duty required the broker “to fully disclose all material facts known to it which might affect the clients’ rights or interests, without ambiguity or reservation.”
 - c. The plaintiffs further claim that the broker’s failure to disclose to its clients all material facts regarding its arrangements for title insurance and closing services for the clients constitutes a fraud, misrepresentation, or deceptive practice under the Minnesota Consumer Fraud Act.

- d. This case – and any unfavorable decision for the real estate broker – could lead to parallel litigation regarding alleged fiduciary relationships in the lending context.
3. Although there is no private cause of action under RESPA for nondisclosure of a YSP, creative plaintiffs have begun bringing their claims under state consumer protection laws and unfair trade practices acts, reinvigorating this requirement of RESPA.
- a. Using consumer protection and unfair trade practices laws brings additional advantages to plaintiffs, as they generally provide for treble damages and/or attorney’s fees – a boon for class counsel.
 - b. Limitations on the breadth of state consumer protection acts vary by state. Some states, such as Washington, impose an “injury” requirement for recovery. Some states, including New Jersey, require that the transaction at issue be for “personal” or “household” purposes – and, therefore, only claims regarding a loan transaction made in connection with a borrower’s primary residence are actionable.
 - c. Another possible defense to these state-law claims is that the transfer of a loan obligation in the secondary market is not covered by RESPA.
 - d. Recovery may be precluded in some states if the lender can demonstrate that the action does not involve the type of conduct intended to be governed by consumer protection statutes. Similarly, sophisticated consumers may be ineligible to recover in certain states.

E. Affiliated Business Disclosures

- 1. Litigants are using RESPA to attack affiliated business agreements, claiming that entities have not satisfied the requirements for the exception set forth in RESPA Section 8(c)(4) (12 U.S.C. § 2607(c)(4)) for affiliated business arrangements.
- 2. *Grady v. Burnet Realty, Inc.*, discussed above, arose in the context of a lender and its affiliated title company. The plaintiffs are contending that providing the documents required by RESPA does not satisfy the fiduciary duty that the broker allegedly owed to its customers.
- 3. Captive Title Reinsurance: RESPA issues have arisen where a lender agrees to use a certain title company and, in exchange, the title company reinsures the title policy with the lender’s reinsurance affiliate. Regulators have claimed that such arrangements provide for payment of a thing of

value by the title company for referrals of title because the amount paid for the reinsurance exceeds the value of the reinsurance services provided.

- a. HUD recently settled three related RESPA investigations regarding homebuilders, where the title insurance company transferred a portion of the risk and title premium to an affiliate of the builder. HUD has taken the position that, with respect to single-family homes, they see “almost no legitimate purpose” for captive title reinsurance arrangements like these.
 - b. A related area concerns private mortgage insurance. Cases are emerging where plaintiffs, on behalf of putative classes, assert that lenders and private mortgage insurance companies have attempted to circumvent RESPA’s prohibition on kickbacks by arranging to have mortgages insurance policies reinsured by the reinsurance affiliate of the lender who referred the primary private mortgage insurance business. These plaintiffs claim that because the reinsurer is assuming very little or no actual risk – despite receiving millions of dollars in premiums – RESPA is violated. *E.g. Alston v. Countrywide Financial Corp.*, No. 06-8174 (C.D. Cal. filed Dec. 22, 2006).
4. *Pettrey v. Enterprise Title Agency, Inc.*, No. 05-1504 (N.D. Ohio filed May 26, 2005): In this case, class certification was denied in December 2006, for claims that the title company set up affiliates that did little or no work but earned fees for loan closings.
 5. Sham Affiliated Business Arrangement Cases: Examples where problems often arise are when the affiliate has no employees, all decisions are made by the parent, or the affiliate deals only with the parent, such as where a broker uses a parent lender for 100% of its loan originations.
 - a. *Yates v. All American Abstract Company, Inc.*, No. 06-2174 (E.D. Pa. filed May 2006): This class action complaint alleges that a title servicer and closing agent allegedly encouraged and assisted a credit union in setting up a sham affiliated business arrangement, with an affiliate abstract company, in order to receive referral fees and kickbacks in violation of RESPA. A motion to dismiss is pending before the court.
 - b. *Carter v. Welles-Bowen Realty*, No. 05-7427 (N.D. Ohio filed Nov. 2005): In this putative class action, the named plaintiffs contend that a realty company, settlement agent, and other entities created a title company as a sham affiliated business arrangement to provide kickbacks and other improper or illegal payments to the realty company in exchange for referrals of settlement work to the settlement agent in violation of RESPA. A hearing on class

certification was held on March 29, 2007. While waiting for a decision, the parties have submitted supplemental post-hearing memoranda.

- c. *Benway v. Resource Real Estate Services, LLC*, No.05-03250 (D. Md. filed Oct. 2005): The named plaintiff filed this class action, asserting that the title company encourages and assists mortgage brokers to set up sham affiliated business arrangements, in order to pay fees and kickbacks for referrals of title services in violation of RESPA and Maryland law. The court granted the plaintiffs' motion to certify a class in October 2006. However, the court denied the plaintiffs' attempt to have the class include consumers whose transactions had occurred within three years of the case filing. Although the plaintiffs urged that their civil conspiracy claim was subject to a three-year statute of limitations, the court concluded that the one-year statute of limitations under RESPA – on which the conspiracy claim was based – was the appropriate limitations period.
 - d. *Pettrey v. Enterprise Title Agency, Inc.*, No. 05-1504 (N.D. Ohio filed May 2005): The plaintiffs filed this case, asserting that the title company set up sham affiliated business arrangements with real estate agents. The plaintiffs contend that the arrangement was intended to allow real estate agents to earn fees for referrals of title and closing work, under the guise of a return on an investment, in violation of RESPA. The court denied the plaintiffs' motion for class certification in December 2006 and denied the motion for reconsideration of that order in March 2007.
- F. Marketing Arrangement Case: *Shahan v. Tower City Title Agency, Inc.*, No. 05-1983 (N.D. Ohio filed Aug. 2005). The plaintiffs in this action allege that the defendants entered into "marketing agreements" with mortgage brokers who were in a position to send title and escrow business to the defendants, and that the defendants paid referral fees to mortgage brokers that were disguised as "promotional fees." The court preliminarily accepted a settlement agreement in January 2007, and a further hearing was scheduled for late April 2007. The settlement agreement provides that the defendants will (i) enter into a consent order prohibiting the use of marketing agreements or otherwise prohibiting the making of payments to any mortgage broker, lender, or other person pursuant to any agreement or understanding that settlement service business shall be referred to any person, and (ii) pay \$900,000 into a settlement fund, plus any unpaid balance of an insurance policy available to the defendants that may exist at the time of final approval of the settlement.
- G. LLC Arrangement Cases: New litigation has emerged challenging the structure of retail mortgage broker businesses. The plaintiffs in these cases contend that the use of limited liability companies established to provide administrative support to

the broker's branch offices is actually an unlawful fee-sharing arrangement. In these cases, compensation received by the broker was distributed to the LLCs, after deducting the branch's office expenses – although, according to the plaintiffs, the LLCs performed no settlement services in connection with the origination of their loans. While some of these claims are being brought under RESPA Sections 8(a) and 8(b), others assert claims only under consumer protection laws.

V. FAIR LENDING

- A. “Fair Lending” addresses the idea that borrowers should not be subjected to unfair or abusive lending practices. Fair lending claims usually present themselves as predatory lending, redlining, or reverse redlining claims. Plaintiffs employ federal statutes, from Section 1981 and Section 1982 to ECOA to the Fair Housing Act, as well as state consumer protection laws and other state statutes, to seek recovery for violations of fair lending.
- B. Abusive lending practices that are often alleged in fair lending claims include the following:
 - 1. Loan Flipping – making a refinance loan that results in no net economic benefit to the borrower.
 - 2. Excessive Fees – charging fees that bear no reasonable relationship to the services actually provided.
 - 4. Packing – selling additional, unnecessary products in a loan agreement.
 - 5. Lending without regard to the borrower's ability to repay.
 - 6. “Bait and switch.”
- C. Agencies and prosecutors use administrative or investigative subpoenas to gather evidence that later may be available to private plaintiffs.
- D. The House Financial Services Committee is expected to hold hearings this year regarding rising subprime mortgage defaults, which may result in national legislation to curb predatory lending.
- E. The Feds have issued proposed subprime lending guidance that urges lenders to analyze a borrower's ability to repay by assuming a fully-amortizing repayment schedule and evaluating whether repayment will occur by the maturity date, at the fully-amortized rate. The proposed guidance is currently in the comment period.
- F. With many new loan products available (e.g. negative amortization loans, pick-and-pay loans) consumer advocates are questioning whether traditional disclosure forms adequately explain the loan terms. In the context of lower-income, higher-risk borrowers, this could raise potential fair lending issues.

G. HUD Complaints Filed by the NCRC

1. In March 2006, the NCRC filed HUD complaints against various lenders under the Fair Housing Act, alleging, inter alia, that lender policies of not issuing loans on rowhouses in certain urban areas and/or restricting loans on rowhouses in certain urban areas to those in excess of \$100,000 are discriminatory. In November 2006, one of the lenders, although denying liability under the statute, entered into a settlement agreement whereby it agreed to discontinue any practice of prohibiting loans on rowhouses and to eliminate any value limits on any of its loan programs. In addition, the settling lender paid \$500,000 to the NCRC.
2. Although there was no admission of liability in the settlement, the terms of the settlement are publicly available and may lead to additional consumer litigation, particularly as the remaining HUD complaints are resolved.

H. Government Actions

1. Recent government settlement: *United States v. Centier Bank*, No. 06-344 (N.D. Ind. Consent Order entered Oct. 16, 2006). The United States brought this action for violations of the Fair Housing Act and ECOA, based on the allegation that the bank unlawfully failed to market and provide its lending products and services on an equal basis to predominantly minority neighborhoods in certain Chicago suburbs. Although the bank denied any discriminatory activity, the Consent Order, which is of public record, provides for the following settlement: The bank will open new offices and expand operations in the affected suburbs, will invest \$3.5 million in a special financing program, and will spend at least \$875,000 for consumer financial education, outreach to potential customers, and promotion of its products and services in the affected suburbs.
2. *McGlawn v. Pennsylvania Human Relations Commission*, 891 A.2d 757 (Pa. Cmwlth. 2006), *appeal denied*, 906 A.2d 545 (table) (Pa. 2006): In a case of first impression, the Commonwealth Court of Pennsylvania, inter alia, affirmed a decision by the Pennsylvania Human Relations Commission that the Pennsylvania Human Relations Act prohibits reverse redlining. The plaintiff's appeal to the Pennsylvania Supreme Court was denied in August 2006.
3. Following a split among Ohio state courts regarding whether local predatory lending ordinances that impose stricter requirements on lending transactions conflict with the state's predatory lending statute, the Ohio Supreme Court took up the issue and answered it in the affirmative in November and December of 2006. *Am. Financial Servs. Assn. v.*

Cleveland, 858 N.E.2d 776 (2006); *Am. Financial Servs. Ass'n v. Toledo*, 859 N.E. 2d 923 (2006). Many other states hold this view.

- I. State consumer protection and unfair and deceptive trade practice laws as an outlet for fair lending claims:
 - 1. Example: *Green v. Branch Banking and Trust Co.* 2007 WL 328723 (N.C. App. February 6, 2007): Lending money to poorly qualified borrower did not constitute unfair and deceptive trade practice.
 - 2. Borrowers sometimes prefer to bring state-law claims to avoid federal jurisdiction. *E.g. Delph v. Allstate Home Mortgage*, 2007 WL 867134 (Mar. 22, 2007) (remanding action to state court).
- J. Conspiracy claims: While the merits of RICO and conspiracy claims based on alleged predatory lending claims may face challenges, the nature of the lending business translates fairly well into pleading the existence of an enterprise or conspiracy. The structure of the industry – which requires that brokers, lenders, title companies, and appraisers work together to some extent for a loan to be issued – appears to create, at least in the view of some courts, a ready-made platform for pleading these claims. *E.g. Carr v. Home Tech Co., Inc.*, 2007 WL 678637 (W.D. Tenn. Mar. 6, 2007).
- K. Bankruptcy Court: Many fair lending cases arise in the Bankruptcy context, which can complicate the litigation.
 - 1. Bankruptcy petitioners sometimes neglect to list their “claims” against their lender on their schedules of assets, which may give rise to the defense of judicial estoppel and/or res judicata in subsequent litigation.
 - 2. In a recent case, a Bankruptcy Court was directed that it could not avoid hearing predatory lending claims under the abstention doctrine, particularly where it elects to hear other claims that are not direct bankruptcy claims. *McDaniel v. ABN Amro Mortgage Group*, 2007 WL 756700 (S.D. Ohio Mar. 8, 2007).
- L. ECOA Developments
 - 1. Counteroffers: The plaintiffs’ bar has previously seized on *Newton v. United Companies Financial Corp.* to argue that counteroffers must be delivered prior to loan closing. In a recent unpublished opinion, the Third Circuit rejected the plaintiffs’ argument that under *Newton* the counteroffer could not be provided at the closing table. The court granted judgment for the creditor because, although notice of the counteroffer was provided at the closing table, it was still within the 30-day period. *Ricciardi v. Ameriquest Mortgage Co.*, 164 Fed. Appx. 221 (3d Cir. 2006).

2. Explanations of Credit Denial: The plaintiffs' bar has also relied on *Fischl v. General Motors Acceptance Corp.* regarding what language may be used to explain the reasons for denial. Recent decisions indicate that courts may be reluctant to expand *Fischl* or to require that the exact language presented in the sample notification forms be used. Instead, as long as the notice at issue is not subject to two possible interpretations, some courts will find it sufficient. *E.g. Aikens v. Northwestern Dodge, Inc.*, 2006 WL 59408 (N.D. Ill. Jan. 5, 2006).

M. Illinois Predatory Lending Database

1. In March 2007, Governor Rod R. Blagojevich directed the Illinois Department of Financial and Professional Regulation to file new rules to the Illinois Predatory Lending Database Pilot Program, also known as HB 4050. Under the revised program, applicants in Cook County would be required to receive financial counseling before receiving certain types of mortgage loans. The program would apply to applicants for loans that permit interest-only payments; allow negative amortization; charge points and fees payable by the borrower that exceed 5% of the loan; rely on the stated income of the applicant; include a prepayment penalty; or involve a second lien on the property, such as an 80/20 loan.
2. The Department opened a 45-day "notice and comment" period, soliciting public and industry comments about the revised rules before they are sent for consideration to a state legislative committee.
3. In April 2007, the not-for-profit community groups that would provide the mandatory financial counseling reported that they were not staffed to handle the program if it were expanded to all of Cook County.
4. The March 2007 revision comes in the wake of poor public reception to the prior rules, as well as a lawsuit filed in December 2006 against, inter alia, Governor Blagojevich for the allegedly predatory effects of the prior rules.

- N. To combat predatory lending, Freddie Mac has announced tougher subprime lending standards. Under its new investment requirements, which will take effect on September 1, 2007, Freddie will cease buying subprime mortgages that it deems likely to lead to excessive payment shock and foreclosure. Instead, Freddie will purchase only subprime ARMs – and mortgage-related securities backed by these subprime loans – that qualify borrowers at the fully indexed and fully amortizing rate. In its announcement, Freddie claims that the new standards will provide greater protection to consumers. Freddie will no longer purchase no-income/no-asset loans and will limit stated-income/stated-asset loans. In addition, the requirements will mandate that the loans Freddie purchases be underwritten to include taxes and insurance.

- O. Soliciting for Plaintiffs: Internet complaint sites feed potential plaintiffs to willing lawyers:
<http://www.consumeraffairs.com/finance/finance__companies.htm>
<<http://www.ripoffreport.com>>
<<http://www.edcombs.com/CM/Actions/Predatory-Mortgages.asp>>
- P. Proactively Stemming the Litigation Tide
 - 1. Refer unsatisfied customers to supervisors.
 - 2. Monitor public complaint websites and offer to fix customers' complaints.

VI. FRAUD

- A. Borrower Fraud
 - 1. Stated Income/Stated Asset and No-Doc Loans: Borrowers sometimes opt for these loans even though they are not qualified for the loan they seek. There is an apparent belief among some borrowers that they need not tell the truth in stating their income and assets, and some borrowers have sued over these loans, even when they have misstated their income on the loan application.
 - 2. Foreclosure Workout Schemes (a/k/a Foreclosure Rescue Fraud, Home Equity Theft, Deed Theft): These arrangements are usually designed by a "foreclosure consultant," who offers to assist homeowners threatened with foreclosure. The consultant arranges for a purchaser – frequently a straw buyer – to obtain the deed, providing for the original homeowner to lease back the property, often under onerous terms and with an option to repurchase.
 - a. In at least one recent case, an original homeowner accepting foreclosure rescue has accused the lender making the loan under the purchase agreement of fraud. In *Phifer v. Home Saver Consulting Corp.*, 2007 WL 295605 (E.D.N.Y. Jan. 30, 2007), the court refused to dismiss the aiding-and-abetting-of-fraud claim against a mortgage lender. The lender was represented at a closing at which misrepresentations were allegedly made in furtherance of a fraudulent rescue scheme to deprive the original homeowner of title.
 - b. In other litigation, lenders issuing loans to subsequent purchasers have faced challenges to the validity of their liens based on rescission provisions in statutes governing foreclosure consultant contracts. Several states have implemented statutes providing for rescission of fraudulent foreclosure rescue transactions (e.g. California, Illinois, Maryland, Minnesota, New York).

3. Pursuant to a memorandum of agreement, the FBI and MBA pledged in March 2007 that they will work together to promote the FBI's Mortgage Fraud Warning Notice. The Notice states that it is a federal crime to make a false statement – regarding income, assets, debt, etc. – in order to influence a lender, and states that such fraud is punishable by up to 30 years in prison, a \$1 million fine, or both. The MBA and FBI will make the Notice available to mortgage lenders for their websites, and the MBA will post it on its website.

B. Title Company/Settlement Agent Fraud

1. Escrow agents/settlement agents/title companies/closing attorneys have been known to:
 - a. Misrepresent or fail to verify that earnest money deposits or down payments have been made;
 - b. Disburse loan proceeds, commissions, or kickbacks inconsistent with what is represented on the HUD-1 settlement statement;
 - c. Prepare multiple versions of a settlement statement, disclosing one version to the lender and another to the seller or borrower;
 - d. Convert loan funds to the agent's own use;
 - e. Fail to ensure timely recordation of deeds, mortgages, and mortgage satisfactions in order to conceal the existence of flipping schemes;
 - f. Fail to disclose "double escrow" transactions, wherein two sales occur on the same day, or within a short period of time;
 - g. Close loans when the borrower is not present;
 - h. Forge or fabricate deeds, mortgages, payoff statements, title policies, title commitments, and other closing-related documents;
 - i. Fail to verify the identity of the purported borrower; and
 - j. Fail to verify fraudulent gift letters.
2. Relief for the lender is sometimes available pursuant to closing protection letters from title insurers, which are available and widely used in most states.

- C. Cash paid back at closing: Lenders are discovering a number of instances where sellers are providing cash back to the borrowers – as incentives to complete the sale – that is not disclosed on the HUD-1 settlement statements. Undisclosed payments from the seller to the borrower violate RESPA, and settlement agents that facilitate such payments are violating the closing instructions from the lender. This practice may also result in a repurchase of the loan by the originating lender as well as claims under the closing protection letter.
- D. Appraiser Fraud:
1. Pushed values: Because conducting an appraisal is not an entirely objective process, it can be difficult for a lender to discern where appraisers have intentionally inflated the value of the subject property. The use of comparable properties as a pricing tool further makes it difficult for lenders to discern where fraud may be present.
 2. Identify theft: In conjunction with flipping schemes and other fraudulent activity, there is an increasing problem with people posing as appraisers and using their electronic signatures to prepare fraudulent appraisals.
 3. FHA regulations currently hold lenders accountable for the quality of appraisals. Some states are adopting a similar approach: In April 2007, the Indiana House and Senate passed a measure that would give permanent status to the Homeowner Protection Unit, which was created two years ago as an interim program. The unit will analyze the relationship between the appraiser, real estate agent, and lender, and will seek disciplinary action against wrongdoers. Similarly, the Colorado Attorney General has recommended mortgage fraud legislation, which would, inter alia, specifically prohibit a mortgage broker from compensating, coercing, or intimidating a real estate appraiser in order to obtain an inflated valuation of the subject property.