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Litigation and Enforcement Update Panel

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I. SUMMARY OF TOPICS

- A. FCRA Update
- B. Privacy and Data Security Developments
- C. Fair Lending Litigation Update
- D. Fair Lending Enforcement Update
- E. RESPA Update
- F. Mortgage Fraud Issues
- G. TILA Update
- H. Preemption Developments
- I. SEC Litigation Issues
- J. State Law Update
- K. Employment Litigation Update
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II. FCRA UPDATE

- 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 “CRAs”) 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 issued an opinion addressing 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. On June 4, 2007, the Supreme Court finally issued its opinion in *Safeco Insurance Co. of America v. Burr*, No. 06-84, and *GEICO General Insurance Co. v. Edo*, No. 06-100. *Safeco Ins. Co. of Am. v. Burr*, 127 S. Ct. 2201 (2007). Reversing Ninth Circuit precedent, the opinion contains four significant holdings, two of which favor plaintiffs and two of which favor defendants.
1. To plaintiffs' benefit, the Court rejected the argument that only knowing violations of the FCRA constitute willful failures to comply. The Court relied on the common-law usage of the term "willful" in civil statutes to find that the term includes reckless disregard, and it also relied on the structure of the statute. To plaintiffs' benefit, the Court also held that, at least in the insurance context, the term "adverse action" includes a disadvantageous rate obtained by a consumer even if the consumer had no prior dealings with the insurance company. According to the Court, the FCRA's expansive goal of protecting consumers from the adverse effect of inaccurate credit reporting means that remedies may be available even to first-time customers.
 2. In defendants' corner, the Court held that, in determining whether a first-time rate is an "adverse action" that triggers the notice requirements of FCRA, the consumer must show that the credit report on which the insurance company relied for the initial rate had an identifiable effect on the insurance rate charged. Most importantly for defendants, the Court held that, in order for a plaintiff to meet that "reckless disregard" standard for willful violation of the FCRA, the plaintiff must establish that the insurance company's reading of the law was not merely objectively unreasonable. The plaintiff must meet the higher burden of proving that the insurance company engaged in an "unjustifiably high risk of harm that is either known or so obvious that it should be known." The company's subjective bad faith, if any, cannot support a willfulness finding based on reckless disregard if the company's reading of the statute is objectively reasonable, albeit erroneous.
- D. "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).
 - a. 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.

- b. 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.
 - c. 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.
 - d. 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.
5. *Bruce v. KeyBank N.A.*, 2006 U.S. Dist. Lexis 91371 (N.D. Ind. Dec. 15, 2006): 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*, 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. Appeal pending.

6. 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)). On appeal; oral argument set for October 24, 2007
7. *Murray v. GMAC Mortgage Corp.*, 2007 U.S. Dist. LEXIS 53777 (N.D. Ill. July 11, 2007): granting reconsideration and defendants’ motion for summary judgment in light of *Safeco* (“Therefore, it appears that the interpretation of ‘firm offer’ used by Defendant has been accepted by other courts. In light of this, and the other factors drawn from the Supreme Court’s ruling in *Safeco*, this Court finds that Defendant’s interpretation of FCRA’s “firm offer” requirement was not objectively unreasonable.”).
8. In *Bernal v. American Money Centers, Inc.*, 2007 U.S. Dist. LEXIS 57274 (E.D. Wis. Aug. 6, 2007), the court found that pre-screened mailings were not a firm offer of credit because the mailings did not disclose the interest rate, method of calculating interest, loan amount, or duration, and it was impossible to determine whether the offer was for value. *Bernal*’s findings with regard to “willfulness” are worse. Applying *Safeco*, the court concluded that two pieces of evidence created a triable issue of fact sufficient to deny summary judgment to the creditor. First, AMC did not have a lawyer review each mailing before AMC sent it out. Second, it did not have a system to actively solicit whether callers were responding to a particular mailing. The court noted that “without such a system, a reasonable finder of fact could conclude that AMC had no intention of honoring any offer allegedly made in the mailing” and that was sufficient to ground a finding of willfulness. 2007 U.S. Dist. LEXIS 57274, at *21.

9. *Poehl v. Countrywide Home Loans*, 2007 U.S. Dist. LEXIS 57620 (E.D. Mo. Aug. 7, 2007): In a highly favorable firm offer decision, a Missouri judge granted Countrywide's motion for judgment on the pleadings, finding that Countrywide made a firm offer of credit when it sent pre-screened flyers for refinancing home loans. Expressly refusing to follow courts that have taken a strict reading of *Cole* and its requirement that pre-screened offers must have "some value," Judge Perry concluded that Countrywide's offer had value and was a firm offer of credit because the offer stated an absolute minimum loan amount of \$50,000, "which is more than a nominal amount." Significantly, this minimum amount was the only set term in the entire flyer.
10. Decisions granting class certification:
 - a. *In re H & R Block Mortgage Corp. Prescreening Litigation*, 2007 U.S. Dist. LEXIS 59112 (N.D. Ind. Aug. 8, 2007) (MDL; granting limited classes in Indiana, Texas, and Wisconsin)
 - b. *Walker v. Calusa Investments, LLC*, 2007 U.S. Dist. LEXIS 53926 (S.D. Ind. July 23, 2007) (class of Indiana residents).
 - c. *Bernal v. Keybank*, 2007 U.S. Dist. LEXIS 50764 (E.D. Wis. July 11, 2007) (class of Wisconsin residents)
 - d. *Holloway v. Full Spectrum Lending*, 2007 U.S. Dist. LEXIS 59934 (C.D. Cal. June 26, 2007) (class of Florida residents)
 - e. *Phillips v. Accredited Home Lenders Holding Co.*, 2007 U.S. Dist. LEXIS 59880 (C.D. Cal. May 15, 2007) (one class of 58,750 individuals and another of 70,585 individuals, pertaining to two different mailers)
 - f. *Hernandez v. Chase Bank USA, N.A.*, 2006 U.S. Dist. LEXIS 96511 (N.D. Ill. Dec. 26, 2006) (class of four counties in Illinois)
 - g. *Kudlicki v. Capital One Auto Finance*, 241 F.R.D. 603 (N.D. Ill. Nov. 11, 2006) ("all persons whom defendants sent or caused to be sent materials in the form represented by Exhibit A to plaintiff's complaint, identified by defendants as offer number 05438-2F ('the mailing'), excluding persons who responded to the mailing and obtained credit as a result, and excluding persons whose credit reports defendants did not pre-screen prior to sending the mailing.")

11. Other rulings:

- a. *Ludditt-Poehl v. Capital One Auto Finance, Inc.*, 2007 U.S. Dist. LEXIS 61444 (E.D. Mo. Aug. 21, 2007) (granting defendant's motion for judgment on the pleadings)
- b. *Sullivan v. Greenwood Credit Union*, 2007 U.S. Dist. LEXIS 59267 (D. Mass. Aug. 13, 2007) (granting summary judgment for defendant)
- c. *McFarland v. Calusa Investments, LLC*, 2007 U.S. Dist. LEXIS 52617 (W.D. Pa. July 20, 2007) (granting motion to dismiss)
- d. *Krey v. Castle Motor Sales, Inc.*, 241 F.R.D. 608 (N.D. Ill. Mar. 21, 2007) (granting defendants' partial motion for judgment on the pleadings and granting class certification.)
- e. *Gelman v. State Farm*, 2007 U.S. Dist. LEXIS 58237 (E.D. Pa. Aug. 9, 2007) (granting motion to dismiss in firm offer of insurance case).

E. Pending Seventh Circuit Appeals

1. *Cavin v. Home Loan Center, Inc.*: oral argument set for October 24, 2007
2. *Bruce v. Keybank*: appellant's reply brief due October 10, 2007
3. *Murray v. HSBC Auto Finance*: oral argument vacated on court's own motion

III. PRIVACY AND DATA SECURITY DEVELOPMENTS

A. Seventh Circuit Says No "Fear of ID Theft"

1. In the first decision on the subject by a federal circuit, the Seventh Circuit on August 23 said "no" to a class action alleging "fear of identify theft." In *Pisciotta v. Old National Bancorp*, 2007 U.S. App. LEXIS 20068 (Aug. 23, 2007), the court declined to engage in "substantive innovation" by finding injury as to persons whose personal data has been compromised but who have not experienced an identity theft. In that case, tens of thousands of bank customers had their personal financial information stolen by a computer hacker and sought to recover damages in the form of reimbursement for the cost of credit-monitoring services they obtained to protect against identity theft.

2. *Pisciotta* confirms what at least four district courts have already held. But those courts dismissed the suits on Article III/standing grounds, which meant that those cases had little utility in actions filed in state court. In *Pisciotta*, the Seventh Circuit held that this result is a construction of Indiana negligence law. Consequently, *Pisciotta* is citable in state court. Expect other courts to follow suit.

IV. FAIR LENDING LITIGATION UPDATE

- 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 Civil Rights Act Section 1981 and Section 1982 to ECOA to the FHA, as well as state consumer protection laws and other state statutes, to seek recovery for violations of fair lending.
- B. New Wave of HMDA Data Disparate Impact Class Actions filed under FHA and ECOA
 1. Numerous cases filed
 - a. *NAACP v. Ameriquest et al.* (C.D. Cal.)
 - b. *Tribett v. BNC Mortgage* (N.D. Ill.)
 - c. *Newman v. APEX* (N.D. Ill.)
 - d. *Ware v. Indymac Bank* (N.D. Ill.)
 - e. *Chavers v. Approved Financial, Inc.* (N.D. Ill.)
 - f. *Jones v. Long Beach Mortgage Co./Washington Mutual* (D. Mass.)
 - g. *Miller v. Countrywide Bank* (D. Mass.)
 - h. *Sanchez v. Washington Mutual* (C.D. Cal.)
 - i. *Payares v. JP Morgan Chase* (C.D. Cal.)
 - j. *Sanchez v. Argent Mortgage Co.* (C.D. Cal.)
 - k. *Ventura v. Wells Fargo Bank* (N.D. Cal.)
 - l. *Puerto v. First Magnus Financial Corp.* (D. Ariz.)
 - m. *Zamudio v. HSBC North America Holdings* (N.D. Ill.)

2. Small number of firms involved:
 - a. Edelman Combs
 - b. Lerach Coughlin, Hagens Berman, Roddy Klein
 - c. Chavez Gertler, Bonnett Fairbourn
 - d. James, Hoyer
3. Some brought on behalf of African-Americans (NAACP, Lerach suits); others brought on behalf of African-Americans and Hispanics and/or all minorities
4. Nature of challenges
 - a. Class actions
 - b. ECOA
 - c. FHA
 - d. Some also allege Civil Rights Act claims under 42 U.S.C. §§ 1981 and 1982
 - e. YSPs targeted
- 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 held hearings this summer 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. 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.* 640 S.E.2d 447 (Table), 2007 WL 328723 (N.C. Ct. App. Feb. 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*, 476 F.Supp.2d 852 (D. Md. 2997) (remanding action to state court).
- H. 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.*, 476 F. Supp. 2d 859 (W.D. Tenn. 2007).
- I. 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 case earlier this year, 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*, 364 B.R. 644 (S.D. Ohio 2007).
- J. 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).

- K. 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>>

- L. Proactively Stemming the Litigation Tide

1. Refer unsatisfied customers to supervisors.
2. Monitor public complaint websites and offer to fix customers' complaints.

V. FAIR LENDING ENFORCEMENT UPDATE

- A. HUD Complaints Filed by the NCRC

1. Recent Settlements:

- a. In June 2007, HUD announced a \$100,000 settlement with First Indiana Bank, N.A., in connection with a complaint filed by NCRC alleging that the bank discriminated on the bases of national origin and race by refusing to make loans on row houses in Baltimore, Philadelphia, and Washington, DC, or loans for less than \$100,000 on any property. The complaint alleged that the bank's lending practices discriminated against African Americans and Hispanics because row houses and properties valued under \$100,000 are more heavily concentrated in African-American and Hispanic neighborhoods. This is the second row house settlement that HUD has reached in less than a year. In September 2006, HUD negotiated a similar settlement with SouthStar Funding LLC, a now defunct, national lender, based on its alleged practice of refusing to make loans on all row houses in Baltimore and any row house valued at less than \$100,000 nationwide.
- b. In May 2007, Aegis Mortgage Corporation agreed to settle a HUD complaint brought by the NCRC alleging that the

lender violated the Fair Housing Act through its policies of prohibiting loans secured by properties located on American Indian reservations, row homes, and group homes for the elderly and persons with disabilities. While denying any wrongdoing or violation of the fair housing law, Aegis agreed to pay \$475,000 to the NCRC and to revise its underwriting criteria to remove any blanket prohibitions against loans secured by row houses, properties located inside Indian reservations, and any form of home to be used to care for elderly or disabled adults. The lender also agreed to eliminate its \$60,000 minimum property value requirement.

2. New Actions:

- a. In May 2007, the NCRC filed HUD complaints against four mortgage lenders, contending that the lenders discriminated against individuals seeking loans for housing on Indian reservations and for group homes for persons with disabilities.
- b. Also in May 2007, the NCRC filed a civil rights lawsuit in federal court against another lender, alleging discrimination based on the lender's policies of prohibiting loans secured by homes on Indian reservations, row houses in Baltimore, and group homes for disabled adults.

B. AG Investigations: Numerous AG investigations are ongoing across the country, arising out of complaints lodged by consumers and the states' concerns over fair lending practices. Various AG offices have been focusing on whether brokers and lenders pressure appraisers to inflate the value of the properties in order to be able to make loans.

C. Private Actions

1. *Coelho v. Alliance Mortgage Banking Corp.*, 2007 WL 1412289 (D.N.J. May 10, 2007): Plaintiff claims that mortgage broker, lender, and title company discriminated against him because he spoke Spanish. The court dismissed the claims against the title company but allowed the suit to proceed against the broker. The court rejected the broker's claim that "language minorities" are not a class specifically protected under New Jersey's anti-discrimination law, noting that the statute should be interpreted liberally.
2. *NAACP v. Ameriquest Mortgage Co.*, No. 07-794 (C.D. Cal. filed July 11, 2007): The NAACP has filed a class action lawsuit

against 14 of the nation's largest subprime lenders. The suit alleges that the lenders and others engage in "systematic, institutionalized racism" in making mortgage loans, thereby causing African-Americans to pay higher mortgage interest rates than Caucasian borrowers.

3. *Anderson v. Wachovia Mortgage Corp.*, 2007 WL 2050452 (D. Del. July 18, 2007): African-American plaintiffs previously obtained mortgage loans from a lender to purchase homes in racially mixed or predominantly minority neighborhoods. Plaintiffs claim that when they attempted to purchase homes in a "white" neighborhood, the lender allegedly required them to meet different appraisal, home improvement, and financial requirements. The court denied the lender's motion to dismiss and allowed the plaintiffs to proceed with their suit under the Civil Rights Act, 42 U.S.C. § 1981.

D. Government Initiatives

1. **Feds Issue Final Statement on Subprime Mortgage Lending:** In June 2007, the Office of the Comptroller of the Currency, the Board of Governors of the Federal Reserve System, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration issued a final Statement on Subprime Mortgage Lending to address issues relating to certain types of adjustable-rate mortgages (ARMs). The statement sets forth the standards that institutions should follow to ensure that borrowers obtain loans that they can afford to repay. The standards include a fully indexed, fully amortized qualification for borrowers, cautions about risk-layering features, clear and balanced disclosures to consumers, and limits on prepayment penalties.
2. **State Regulators Issue Statement on Subprime Mortgage Lending:** In response to the Feds' Final Statement on Subprime Mortgage Lending, the Conference of State Bank Supervisors (CSBS), the American Association of Residential Mortgage Regulators (AARMR), and the National Association of Consumer Credit Administrators (NACCA) issued a similar statement to the state agencies that regulate residential mortgage lenders and brokers. State regulators had previously endorsed the Feds' statement and announced plans to issue a similar statement to cover lenders not regulated by the federal financial regulatory agencies. The CSBS/AARMR/NACCA statement substantially mirrors the federal statement and outlines clear management practices, underwriting standards, and consumer protection provisions that institutions should follow when marketing and selling certain

ARMs products to borrowers. However, the state mortgage regulators modified the statement to address issues particular to non-depository mortgage lenders and brokers who originate loans but do not hold them in portfolio.

3. **Pilot Project to Improve Supervision of Subprime Mortgage Lenders:** Three federal agencies and two associations of state regulators will join to conduct targeted consumer-protection compliance reviews of selected non-depository lenders with significant subprime mortgage operations. The participating entities are the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, the Federal Trade Commission, the Conference of State Bank Supervisors, and the American Association of Residential Mortgage Regulators. The project will focus on selected non-depository subsidiaries of bank and thrift holding companies, as well as mortgage brokers doing business with these entities. Additionally, the states will conduct coordinated examinations of independent state-licensed subprime lenders and their associated mortgage brokers. The agencies will evaluate underwriting standards and senior management oversight of the risk-management practices used to ensure compliance with state and federal consumer protection regulations and laws.
4. **New HUD Office:** In July 2007, HUD announced the creation of a new Fair Lending Division for the purpose of reviewing mortgage lending practices throughout the country and investigating allegations of mortgage lending discrimination. Specifically, the new division will investigate discrimination complaints against lenders who have allegedly violated the Fair Housing Act by refusing to make mortgage loans, refusing to provide consistent information regarding loans, or imposing different terms or conditions for granting a loan, such as factors based on the race or national origin of the borrower. The division will also conduct investigations where lending patterns or other information suggests discrimination by a lender, but no individual has filed a complaint. In addition, the division will handle HUD's oversight responsibility for Fannie Mae and Freddie Mac to ensure that their underwriting policies and practices comply with fair lending laws.
5. In July 2007, the Federal Trade Commission provided testimony before the House Financial Services Committee, Subcommittee on Oversight and Investigations, that the agency is conducting several fair lending investigations of mortgage lending companies and working with other agencies to enforce the laws against lending discrimination and predatory lending.

E. Proposed Federal Anti-Predatory Lending Legislation

1. In light of the record number of subprime mortgage defaults and the prospect of an increasing number of foreclosures as the interest rates for adjustable rate mortgages reset over the next two years, both houses of Congress have stepped up efforts to enact anti-predatory legislation.
2. Borrower's Protection Act of 2007 (S. 1299): This proposed legislation includes two components: \$300 million in federal funds to assist homeowners in avoiding foreclosures and an upgrading of the standards for all loan originators and mortgage brokers to insure that borrowers can repay their loans. The bill would provide \$300 million in federal funds to be directed to community non-profit groups via HUD, to boost refinancing programs to help homeowners avoid foreclosures. The legislation also contemplates that the private sector may contribute matching funds to assist in the foreclosure prevention effort. In addition, the bill seeks to impose further regulations on mortgage brokers and originators under the existing Truth in Lending Act. Specifically, the bill would (1) establish a fiduciary duty for mortgage brokers and other non-bank mortgage originators; (2) create a good faith and fair dealing standard for all originators; (3) require originators to underwrite loans at the fully indexed rate; (4) require originators to create escrow accounts to pay taxes and hazard insurance on subprime loans; (5) prohibit steering (i.e., counseling a consumer to rates, charges, or prepayment terms that are not appropriate or suitable for them); (6) hold lenders responsible for policing their associated appraisers and brokers; and (7) prohibit originators from influencing the appraisal process.
3. Predatory Mortgage Lending Practices Reduction Act (H.R. 2061): This House bill would amend the Real Estate Settlement Procedures Act to prohibit any person, in connection with a subprime federally related mortgage loan, from providing mortgage lending services or mortgage brokerage services unless such person is certified by the Secretary of Housing and Urban Development as having been adequately trained with regard to subprime lending. The legislation would also amend the Truth in Lending Act to require lenders to establish best practices plans to ensure compliance with the Act for high cost mortgages. Further, the bill prohibits unfair or deceptive acts or practices in providing: (1) mortgage lending services for either a subprime federally related mortgage loan; (2) mortgage brokerage services for such a loan; and (3) appraisal of a property offered as security for repayment of the loan.

4. Fair Mortgages Practices Act of 2007 (H.R. 3012): This proposed legislation would amend the Truth in Lending Act, inter alia, to provide for the establishment of fair mortgage practices generally, and for subprime mortgages in particular, to provide for a national system for licensing or registering residential mortgage loan originators.
5. Fairness for Homeowners Act of 2007 (H.R. 3081): This bill would amend the Truth in Lending Act, inter alia, to protect consumers from certain practices in connection with the origination of consumer credit transactions secured by the consumer's principal dwelling.

F. State Predatory Lending Legislation

1. Legislators in more than 30 states have introduced nearly 100 bills aimed at curbing deceptive lending practices and foreclosures.
2. For example, North Carolina has enacted legislation that would limit the ability of mortgage brokers to charge above-market rates and prepayment penalties and would also protect subprime borrowers from certain types of adjustable rate mortgages.
3. Minnesota's predatory lending statute was recently amended to prohibit mortgage originators from arranging mortgages without verifying the borrower's income and ability to repay the loans, or arranging for loans that do not benefit the borrower.
4. A bill introduced in New York would prevent financial institutions from foreclosing on certain subprime mortgages for a certain period of time and would create a temporary state commission on foreclosures due to deceptive subprime lending practices.
5. The Illinois legislature recently passed a law requiring residents of Cook County to receive financial counseling before receiving certain types of mortgage loans, such as ARMs that adjust within three years and loans containing prepayment penalties. The law is scheduled to go into effect in July 2008. The passage of this bill comes after the suspension last year of the Illinois Predatory Lending Database Pilot Program. The original program, which was limited to 10 zip codes on Chicago's southwest side, was heavily criticized for disproportionately affecting minority homeowners and making it harder for them to acquire loans.
6. Following a split among Ohio state courts, the Ohio Supreme Court held that local predatory lending ordinances that impose stricter requirements on lending transactions that the state's predatory lending statute conflict with and are thus preempted by

the state law. *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.

G. 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.

H. Freddie Mac Initiatives

1. 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.

2. Despite its tougher standards, Freddie Mac states that it remains committed to supporting the subprime market. In recent Congressional testimony, Freddie Mac announced that it has earmarked \$20 billion over the next several years to the development of subprime products and underwriting processes that will help transition the subprime market into a more stable source of financing for consumers.

VI. RESPA UPDATE

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 district 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 oral argument was held on August 2, 2007. Meanwhile, 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. *Cohen v. JP Morgan Chase & Co.*, --F.3d --, 2007 WL 2231106 (2d Cir. Aug. 6, 2007): The Second Circuit reversed the district court’s dismissal of this putative class action, holding that an undivided, unearned fee charged by a single service provider – i.e., not shared or split with a third party – gave rise to a claim under Section 8(b). The plaintiff challenged a \$225 “post-closing fee,” a charge for which she claimed the lender provided no services. In its decision, the Second Circuit assumed, for purposes of the lender’s motion to dismiss only, that this allegation was true and rejected the district court’s reasoning that the challenged fee was analogous to and controlled by the court’s analysis of overcharges in *Kruse*, which were previously held to be beyond the reach of Section 8(b). Finding that the statute was ambiguous as to whether Section 8(b) requires that unearned fees be divided between two or more people, the court afforded *Chevron* deference to HUD’s policy statement on the issue, which advises that a single service provider that charges undivided, unearned fees violates Section 8(b).
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. A motion to dismiss is pending. A title insurer was successful on a motion to dismiss in a similar case in the Southern District of Alabama. The plaintiffs there claimed that by charging more for title insurance than was permitted by the Alabama Department of Insurance, the insurer violated Section 8(b), because the additional amount charged was a “markup.” The court rejected that argument, holding that because the plaintiffs were challenging the *amount of* the fee, which under the applicable statute was for services rendered, it could not be deemed an “overcharge.” Reasoning that Section 8(b) addresses only the practice of being paid for doing nothing, rather than being paid too much, the court dismissed the case against the title

insurer. *Morrisette v. NovaStar Home Mortgage, et al.*, 484 F. Supp. 2d 1227 (S.D. Ala. Apr. 19, 2007); see also *Williams v. Saxon Mortgage Services, Inc.*, 2007 WL 1845642 (S.D. Ala. June 25, 2007).

4. 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 conference held June 19, 2007, stay in effect); *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. 2006; class certified on state-law claims, settlement conference scheduled).
5. *Santiago v. GMAC Mortgage*, No. 02-4048 (E.D. Pa.): Following the Third Circuit August 2005 seminal decision in this case – holding that RESPA Section 8 does not provide a cause of action for overcharges but does provide a cause of action for markups, and remanding the case for further proceedings – a settlement agreement was approved by the district court on August 7, 2007. Pursuant to the agreement, GMAC will create a settlement fund of \$650,000, of which \$325,000 will be dispersed among the 81,981 class members and the remaining \$325,000 will go to attorney's fees and costs. Class members who paid the alleged markup of \$9 for flood certification fees will receive \$14.40 under the agreement, while those who paid a \$1 markup will receive approximately \$2. Of the ten class members who opted out of the settlement, two sent letters to the court, claiming that settlement was “nonsense” where “[o]nly the attorneys win,” and that “[s]uch lawsuits are a major source of inflation in the American marketplace.”

C. Yield Spread Premiums

1. What constitutes a violation?
 - a. *Culpepper v. Irwin Mortgage Corp.*, 491 F.3d 1260 (11th Cir. July 2, 2007): In its most recent opinion in this case, *Culpepper IV*, the Eleventh Circuit declined to apply its holding in *Culpepper III* and held that, in light of the 2001 HUD Statement of Policy issued in response to *Culpepper III*, the issue whether a YSP constitutes a kickback under

RESPA Section 8(a) involves two questions: (1) were compensable services performed by the broker; and (2) was the total compensation paid to the broker reasonable? The court emphasized that the fact that borrowers' up-front closing costs are not reduced even though the broker received a YSP is insufficient to establish that the total compensation was unreasonable. The court also rejected the position urged by the borrowers that broker compensation in excess of 1% of the loan amount is *per se* unreasonable. The court then affirmed the district court's order that the lender was entitled to summary judgment, because the borrowers failed to present any evidence that the fees paid to the broker were "unreasonable in light of the total array of services performed." The court further affirmed the district court's order decertifying a class, following the HUD Statement of Policy that the legality of an YSP must be assessed in light of the specific facts and circumstances of each individual borrower's transaction.

- b. *Clifford v. FMF Capital, LLC*, 2007 WL 1701816 (W.D. Mich. June 11, 2007): The district court held that the mortgage broker, who received \$1,500 in origination fees and a \$1,200 YSP on a \$62,000 loan, violated Section 8(a) by accepting a YSP from the lender that was neither reasonable in amount nor related to actual goods or services. In granting the plaintiff's motion for summary judgment, the court held that the only "services" provided by the broker were: consulting with the borrower; completing an application for a fixed rate conventional loan; completing a second falsified application for an adjustable rate mortgage that erroneously stated that she was employed; and obtaining one sole lending offer for the borrower. The opinion used strong language, implicitly describing the broker as a "crook."

2. How much disclosure is required under Section 5(c)?

- a. 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.
- b. 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).

- c. State courts in several jurisdictions have held that state law requires that the YSP disclosure provide 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 RESPA’s disclosure requirements, 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 – 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. The court has scheduled the class certification hearing for November 2007. 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. 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.
 - c. Possible defenses to these state-law claims include that the transfer of a loan obligation in the secondary market is not covered by RESPA. However, at least one district court has rejected this view, and the plaintiffs' bar is testing the theory in other jurisdictions.

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. Homebuilder cases: The plaintiffs' bar has filed multiple putative class action lawsuits in various federal district courts alleging that homebuilders violated Sections 8(a) and 8(b) by requiring the use of the homebuilders' affiliated mortgage lending companies and title companies. In these suits, all brought by the same syndicate of law firms, the homebuilders offered discounts and rebates on home sales prices, upgrade packages, or closing costs, on the condition that the homebuyers use the affiliates' settlement services – although the homebuilders' disclosures to the buyers indicated that they were free to use a service provider of their choice. The plaintiff buyers contend that the offered incentives constitute a “required use,” which precludes the homebuilders and their affiliates from relying on the Section 8(c)(4) affiliated business arrangement exemption. The homebuilders have argued on motions to dismiss that the buyers lack standing to sue because they have not alleged they paid any inflated settlement charges and, further, that the offering of the aforementioned types of discounts and rebates does not constitute a “required use” under Regulation X.
4. 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 several 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), transferred to E.D. Pa. Aug. 13, 2007, No. 07-3508.

5. Sham Affiliated Business Arrangement Cases: Examples where problems often arise include 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. The parties are conducting discovery and the plaintiffs’ motion for class certification is due in October 2007.
 - b. *Carter v. Welles-Bowen Realty*, 493 F. Supp. 2d 921 (N.D. Ohio 2007): In this putative class action, the named plaintiffs alleged that a realty company, settlement agent, and other entities created a title company 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. The court dismissed the case in May 2007, holding that because the plaintiffs did not allege that they paid inflated charges for title insurance or settlement services, or that they suffered any other concrete injury, they lacked standing to bring a RESPA claim. The plaintiffs have appealed to the Sixth Circuit.
 - i. In reaching its decision, the *Carter* court rejected the plaintiffs’ argument that the damages provision contained in 12 U.S.C. § 2607(d)(2) provides for treble damages of the entire settlement fee, rather than only the amount of any alleged “overcharge.” The fact that plaintiffs failed to allege that they paid inflated charges for the services thus precluded them from any damages.

- ii. Other courts have resolved the trebling issue differently, including the Eastern District of Pennsylvania in *Yates*, cited above. In denying defendants' motion to dismiss the plaintiff's RESPA claims, the court held that the plaintiff may seek three times the amount she paid for the settlement services, regardless whether she paid a markup for those services.
 - iii. The Central District of California recently criticized and rejected the reasoning of *Carter* in *Berger v. Property I.D. Corp.*, No. 05-5373 (C.D. Cal. filed July 2005). In this putative class action, plaintiffs claim that certain mortgage brokers formed LLCs with the provider of Natural Hazard Disclosure Reports, which are required disclosures in certain parts of California. Plaintiffs allege that the defendants created the LLCs to cover up kickbacks or referral fees from the Report provider to the mortgage brokers, in violation of RESPA. On August 17, 2007, the court denied defendants' motions to dismiss, inter alia, the RESPA claims. The court held that 12 U.S.C. §2607(d)(2) plainly requires, by its reference to damages available in connection with settlement services "involved in the violation," that if a defendant provides three services but accepts a kickback only in connection with one of those services, the plaintiff's damages are limited three times the amount paid, in total, for that one service. The court went on to reject the defendant's argument that only the "illegal" portion of fee paid for that one service is subject to the trebling provisions of RESPA, rejecting what it referred to as the *Carter* court's reading absent words into the damages provision to change its meaning.
- c. *Benway v. Resource Real Estate Services, LLC*, No. 05-03250 (D. Md. filed Oct. 2005): The named plaintiffs 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. Notice has been given to approximately 300 class members.

- d. *Pettrey v. Enterprise Title Agency, Inc.*, No. 05-1504 (N.D. Ohio filed May 2005): The plaintiffs in this action assert 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.
- e. HUD habitually enters into settlement agreement after conducting investigations into affiliated business arrangements between lenders, brokers, title companies, settlement agents, and/or lenders.

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 parties negotiated a proposed settlement agreement which 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. The court approved the proposed settlement in late April 2007.

G. LLC Arrangement Cases: Recent 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), some plaintiffs are asserting claims only under consumer protection laws.

- H. Equitable Tolling of RESPA Claims: In *Boudin v. Residential Essentials, LLC*, 2007 WL 2023466 (S.D. Ala. July 10, 2007), the district court denied a closing agent’s motion to dismiss a RESPA claim as untimely. The plaintiff is challenging a \$120 recording fee because the actual fee charged by the probate court was only \$48. In support of the plaintiff’s argument for equitable tolling, the plaintiff alleged that the HUD-1 was “calculated to deceive him,” because it failed to identify that the closing agent received the recording fees, despite the fact that other fees paid to the closing agent were specifically identified on the HUD-1. In light of these allegations, the court declined to dismiss the complaint as outside the statute of limitations.

VII. MORTGAGE FRAUD ISSUES

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.

- 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.

VIII. TILA UPDATE

A. Availability of Class Actions for Rescission. In decisions earlier this year, courts have split over whether TILA, 15 U.S.C. § 1635, allows class actions for rescission claims.

1. No: *McKenna v. First Horizon Home Loan Corp.*, 475 F.3d 418 (1st Cir. Jan. 29, 2007).
 - a. In *McKenna*, the First Circuit held that TILA does not allow for rescission class actions. The First Circuit followed a more than two-decades old decision of the Fifth Circuit in *James v. Home Constr. Co. of Mobile, Inc.*, 621 F.2d 727 (5th Cir. 1980), finding that “Congress did not intend rescission suits to receive class-action treatment.”
 - b. The Circuit Court found that unlike the specific reference to class actions in relation to damage claims under Section 1640(a)(2)(B), “there is, however, no comparable mention of the class-action mechanism in the section that deals with rescission [Section 1635].” In addition, the Court found that “the highly individualized character of this [rescission] process and the range of variations that may occur render rescission largely incompatible with a sensible deployment of the class-action mechanism.”
2. No: The California Court of Appeal in *LaLiberte v. Pacific Mercantile Bank*, 147 Cal. App. 4th 1 (Jan. 25, 2007), review denied 2007 Cal. LEXIS 4704 (May 9, 2007), cited *McKenna* to hold that borrowers are not entitled to pursue rescission class actions. Plaintiff filed a petition for cert. with the U.S. Supreme Court on August 7, 2007.
3. Yes: In *Andrews v. Chevy Chase Bank, FSB*, (E.D. Wis. Jan. 16, 2007), the court certified a class of borrowers who obtained adjustable rate mortgages from Chevy Chase with a TIL containing any one of three disclosures that the court found deficient for purposes of seeking a declaratory judgment that they may rescind their loans.
 - a. The District Court found “there was nothing in the language of TILA which precludes the use of the class action mechanisms provided by *Rule 23* to obtain a judicial declaration whether an infirmity in the documents, common to all members of the class, entitles each member of the class individually to seek rescission.” (quoting *Rodrigues v. Members Mortgage Co.*, 226 F.R.D. 147, 15 (D. Mass.

2005)). The court did not consider as significant the class action damage cap added to § 1640 in 1974 but not referenced in § 1635 regarding rescission claims. Although citing *McKenna*, this court used this same reasoning to reach to opposite result.

- b. The District Court also opined that “public policy strongly favors allowing class actions” in this type of case, which it felt involved “public wrongs and widespread injuries.”
 - c. The District Court also granted plaintiffs’ summary judgment motion in part, finding that the TIL did not “clearly and conspicuously” disclose the payment terms by omitting the payment periods for all but the first and last payments (i.e., by neglecting the word “monthly”) even though it was disclosed elsewhere that payments were due monthly. The District Court appears to follow the decision of the Northern District of Illinois in *Washington v. Ameriquest Mortgage Co.*, 2006 U.S. Dist. LEXIS 50804 (N.D. Ill 2006) and to reject *Hamm v. Ameriquest Mortgage Co.*, 2005 U.S. Dist. LEXIS 21755 (2005). The District Court also found that (i) the disclosure of the cost of the loan as an annual percentage rate was unclear due to repeated references implying that the yearly rate was 1.950 % when the composite APR was 4.047%; and (2) the TIL did not clearly disclose that the loan had a variable interest rate feature by stating that the loan was a “5-year fixed” loan when only the payments, and not the interest rate, was fixed for five years.
 - d. The District Court found that the negative amortization disclosure was sufficient even though it did not track the language of the commentary to § 226.19(b)(2)(v) of Reg. Z.
 - e. The case is stayed while on appeal to the Seventh Circuit. 474 F. Supp. 2d 1006 (E.D. Wis. Feb. 14, 2007).
4. Yes: The Northern District of Illinois followed *Andrews* in *In re Ameriquest Mortgage Co. Mortgage Lending Practices Litigation*, 2007 U.S. Dist. LEXIS 29641 (N.D. Ill. Apr. 23, 2007), to find that “nothing in TILA preclud[es] declaratory relief authorizing class members to individually request rescission where they are legally entitled to do so.” The District Court denied defendants’ motion to dismiss as a result.

- B. Rescission After Pay off. The most recent authorities say the answer is “yes.”
1. In *Barrett v. JP Morgan Chase Bank, N.A.*, 445 F.3d 874 (6th Cir. Apr. 18, 2006), the Sixth Circuit held that a refinancing does not extinguish the right to rescind. The court concluded that “neither the Act nor the regulations say that the right [to rescind] persists only as long as the security interest does, and of course, the right applies to the ‘transaction,’ not just the security interest.” The right to rescind also allows the borrower to seek the return of statutorily identified finance charges. In so holding, the Sixth Circuit rejected the Ninth Circuit’s long-standing ruling in *King v. California*, 784 F.2d 910 (9th Cir. 1986), and noted that most district courts had done likewise.
 2. In *Handy v. Anchor Mortgage Corp.*, 464 F.3d 760 (7th Cir. Sept. 29, 2006), the Seventh Circuit followed *Barrett* to allow a rescission remedy after the loan paid off.
 - a. The Seventh Circuit also found that the lender’s use of two different notice of right to cancel form (Reg. Z H-9 and Reg.Z H-8 forms) in the same transaction was ambiguous as to the effects of rescission. The fact that there was no confusion on the borrower’s part was found to “miss[] the point” because the legality of the disclosure “depends on the contents of the form, not on how it affects any particular reader.” (quoting *Smith v. Check-N-Go of Ill., Inc.*, 300 F.3d 511, 515 (7th Cir. 1999)).
 - b. *But see Santos-Rodriguez v. Doral Mortgage Corp.*, 485 F.3d 12 (1st Cir. Apr. 19, 2007), rejecting the Seventh Circuit’s reasoning in *Handy* as a “hyper-technical view of the TILA,” which had been replaced by a “clear and conspicuous standard.” Thus, the lender’s use of Form H-8 when Form H-9 was more appropriate was not a *per se* violation of TILA and Reg. Z and adequately informed the borrowers of their right of rescission and effects thereof.
 3. *Barrett* was also followed by the California Court of Appeal in *Pacific Shore Funding v. Lozo*, 138 Cal. App. 4th 1342, (Cal. App. 2d Dist. 2006).

- C. Rescission without Tender. The Fourth Circuit in *American Mortgage Network, Inc. v. Shelton*, 486 F.3d 815 (4th Cir. May 14, 2007), found that rescission was properly denied by the trial court when the borrower was unable to tender payment of the loan amount.
1. The Fourth Circuit found that “[t]he equitable goal of rescission under TILA is to restore the parties to the ‘status quo ante,’ but not ‘to reduce the mortgage company to an unsecured creditor or to simply permit the debtor to indefinitely extend the loan without interest.’”
 2. The court adopted the “majority view of reviewing courts that unilateral notification of cancellation does not automatically void the loan contract,” citing *Yamamoto v. Bank of New York*, 329 F.3d 1167 (9th Cir. 2003), *Large v. Conseco Fin. Servicing Corp.*, 292 F.3d 49 (1st Cir. 2002), and *Williams v. Homestake Mortgage Co.*, 968 F.2d 1137 (11th Cir. 1992).
- D. Miscellaneous rulings concerning disclosure obligations
1. “Disguised” broker fee is not required to be included in a HOEPA “points and fees” calculation. *Cunningham v. Nationscredit Fin. Servs. Corp.*, 2007 U.S. App. LEXIS 19274 (7th Cir. Aug. 14, 2007). The Seventh Circuit affirmed the District Court’s grant of summary judgment in favor of the mortgage lender defendant, finding that the sham entity shown on the HUD-1 was not the broker on the transaction and the borrowers had signed the HUD-1 affirming its accuracy. The court stated: “We have said before that TILA ‘is not a general prohibition of fraud in consumer transactions or even in consumer credit transactions. Its limited office is to protect consumers from being misled about the cost of credit.’” (quoting *Gibson v. Bob Watson Chevrolet-Geo, Inc.*, 112 F.3d 283, 285 (7th Cir. 1997)).
 2. Itemization of the components of the finance charge is not a “material disclosure” and the failure to provide an itemization would not entitle a plaintiff to rescission. *Rivers v. Credit Suisse Boston Fin. Corp.*, 2007 U.S. Dist. LEXIS 23621 (D.N.J. Mar. 30, 2007). The District Court found that “it is sufficient under TILA that defendant included the amount of the ‘points payable’ to Allied [the mortgage broker] in the finance charge.”
 3. All TILA disclosures must be made by the creditor (rather than its designee). *Vallies v. Sky Bank*, 432 F.3d 493 (3^d Cir. 2006). The Third Circuit rejected the contention that disclosure obligations could be delegated to or satisfied by the dealer.

4. TILA does not require disclosure of the method for calculating interest. *Haynes v. HomEq Servicing Corp.*, 2006 WL 2167375 (M.D. Tenn. Aug. 1, 2006).
 5. 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.
 6. 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.
- E. *Sterten v. Option One Mortgage Corp.*, No. 06-651, 2007 U.S. Dist. LEXIS 21201 (E.D. Pa. Mar. 22, 2007), held that TILA's "tolerances for accuracy" provision is not an affirmative defense that is waived if not pled.. The District Court explained that "a matter that merely negates an element of the plaintiff's prima facie case is not an affirmative defense."

IX. PREEMPTION DEVELOPMENTS

A. OCC Preemption:

1. In *Wachovia Bank, N.A. v. Watters*, the Supreme Court affirmed the Sixth Circuit's decision in *Wachovia Bank, N.A. v. Watters*, 550 U.S. ___, 127 S. Ct. 1559, 167 L. Ed. 2d 389 (Apr. 17, 2007), finding that: "Security against significant interference by state regulators is a characteristic condition of the "business of banking" conducted by national banks, and mortgage lending is one aspect of that business. That security should adhere whether the business is conducted by the bank itself or is assigned to an operating subsidiary licensed by OCC whose authority to carry on the business coincides completely with that of the bank." 127 S. Ct. at 1571, 167 L. Ed. 2d at 405 (citations omitted).
2. In *SPGGC, LLC v. Ayotte*, 488 F.3d 525 (*1st Cir. May 30, 2007*), the First Circuit ruled that the National Bank Act and the Home Owner's Loan Act preempt a state's attempt to limit the sale of certain prepaid gift cards. Even though a third party had marketed and sold the gift cards for the banks and thrifts, the court found that because the consumer's relationship was with the bank or thrift and

the bank or thrift was also the sole recipients of the fees and charges associated with the cards, the statute indirectly interfered with the powers granted under the National Bank Act and HOLA.

3. In *Martinez v. Wells Fargo Bank, N.A.*, 2007 U.S. Dist. LEXIS 58758 (E.D. Cal. July 31, 2007), the District Court for the Eastern District of California found that the National Bank Act preempted state law claims for unfair business practices based on automated underwriting and tax service fees charged by Wells Fargo or its subsidiaries and dismissed those claims.
4. *Nat'l City Bank of Indiana v. Turnbaugh*, 2006 U.S. App. LEXIS 20538 (4th Cir. Aug. 10, 2006)
 - a. Affirms grant of summary judgment in favor of National City Bank of Indiana and its Maryland-chartered mortgage subsidiaries, National City Mortgage Co. and First Franklin Financial Corp., in a suit by Charles W. Turnbaugh, commissioner of financial regulation at the state Department of Labor, Licensing and Regulation. On appeal, 39 other states and the District of Columbia signed on as amici in support of Maryland's position.
 - b. Held Maryland cannot enforce a law that limits prepayment penalties on adjustable rate mortgages if the lender is an operating subsidiary of a national bank. National Banking Act and OCC regulations of the federal pre-empt the Maryland Mortgage Lender Law. "If state law applied to operating subsidiaries to a greater extent than it applied to their parent national banks, it would frustrate national banks' right to conduct the 'business of banking' through operating subsidiaries."
5. *Wachovia Bank, N.A. v. Burke*, 414 F.3d 305 (2d Cir. 2005). OCC's operating subsidiary preemption regulations are valid and entitled to deference. However, they provide no basis for federal subject matter jurisdiction of challenge to state regulation; preemption defense must be presented in state court.
6. *Wells Fargo Bank, N.A. v. Boutris*, 419 F.3d 949 (9th Cir. 2005). California corporate regulator's authority to order operating subsidiaries of banks to conduct audits to determine whether California law was violated is preempted by National Bank Act and pertinent federal regulations. Federal regulations also field-preempt California's licensing authority over such entities.

7. *Fuchs v. Wachovia Mortgage Corp.*, No. 17000-03, 2005 N.Y. Misc. LEXIS 2545 (N.Y. Sup. Ct. Nov. 15, 2005). Plaintiffs alleged that the mortgage lender's practice of charging for document preparation fees constituted the unlawful practice of law. The district court dismissed the claims, holding that state laws were preempted by the National Bank Act and OCC regulations.
8. HMDA Fight: *Office of Comptroller of the Currency v. Spitzer*, 396 F. Supp. 2d 383 (S.D.N.Y. 2005) (OCC preemption regulation is valid and precludes state attorney general from enforcing state's anti-discrimination law against national bank as parens patriae); *Clearing House Ass'n v. Spitzer*, 394 F. Supp. 2d 620 (S.D.N.Y. 2005) (same).
9. But see *Smith v. Wells Fargo Bank*, 135 Cal. App. 4th 1463, 38 Cal. Rptr. 3d 653 (2006) (OCC regulations do not preempt a UCL "unlawful" claim based on failure to make disclosures about account charges, as required by OCC regulations or based on breach of accountholder agreement).
10. See also *Kroske v. U.S. Bank Corp.*, 432 F.3d 976 (9th Cir. 2005) (National Bank Act does not preempt Age Discrimination in Employment Act or analogous state law).

B. OTS Preemption:

1. *Weiss v. Washington Mutual Bank*, 147 Cal. App. 4th 72 (Cal. 2d Dist. Ct. App. Jan. 29, 2007), review denied 2007 Cal. LEXIS 5141 (Cal. May 16, 2007), the California Court of Appeal found that a borrower's claims regarding prepayment penalties charged by an OTS regulated savings bank were preempted by HOLA. A plaintiff cannot avoid preemption by attempting to assert claims against a bank employee for fraud when the employee has acted solely within the course and scope of his employment.
2. *Silvas v. E*Trade Mortg. Co.* 421 F.Supp.2d 1315 (S.D. Cal. 2006) This case held that OTS regulations preempt UCL claim based on TILA violation. The longer statute of limitations under the UCL is an additional regulation that conflicts with OTS preemption of entire field of lending, including fees and advertising.
3. State law challenges to yield spread premiums dismissed: *Monroig v. Washington Mutual Bank*, 19 A.D.3d 563, 800 N.Y.S.2d 416 (N.Y. App. Div. 2005) (Homeowners Loan Act preempts state law claims against lender for paying broker a YSP); *Pearson v. Bank of America*; *Kleiman v. Washington Mutual Bank*

4. State law challenges to processing of prepay penalty dismissed: *Zorfas v. CitiMortgage, Inc.* (San Francisco Superior Court, Mar. 3, 2005).

C. FDIC Preemption:

In *Vaden v. Discover Bank*, 489 F.3d 594 (4th Cir. June 13, 2007), the Fourth Circuit found that the Federal Deposit Insurance Act preempted state law usury claims against a state chartered and federally insured bank, stating: “Given the express preemption language of the FDIA, the statute's legislative history affirming Congress' intent to provide competitive equality between national and state-chartered banks, the virtual identity of the preemption language in the NBA and that of the FDIA, and the Supreme Court's finding of complete preemption under the NBA, we are hard-pressed to conclude other than that Congress intended complete preemption of state-court usury claims under the FDIA.”

D. DIDMCA and AMTPA Preemption:

1. Federal Cases:

- a. *Cabrejas v. Accredited Home Lenders, Inc.*, 2007 U.S. Dist. LEXIS 51105 (D. Md. July 5, 2007), held that AMTPA preempted Maryland state law prohibiting balloon loans.
- b. *Quicken Loans, Inc. v. Wood*, 449 F.3d 944 (9th Cir. 2006), follows *Wells Fargo Bank v. Boutris* 419 F.3d 949 (9th Cir. 2005), in holding that DIDMCA does not preempt California's per diem interest statute (Civ. Code § 2948.5), which forbids a lender from charging interest for more than a day before the deed of trust is recorded. It goes a step further, holding that the Alternative Mortgage Transaction Parity Act, 12 U.S.C. §§3801-06 does not preempt the per diem interest statute either.
- c. *Wells Fargo Bank, N.A. v. Boutris*, 419 F.3d 949 (9th Cir. 2005).
- d. *McCarthy v. Option One Mortgage Corp.*, 362 F.3d 1008 (7th Cir. 2004) held that DIDMCA preempts state law barring prepayment penalty; substantial compliance with OTS regulations suffices to invoke preemption).

2. State Cases:

- a. *Patrick v. Pines Investment Corp.* 2007 Mich. App. LEXIS 970 (Mich. Ct. App. Apr. 10, 2007), held that the preemption provisions of DIDMCA and AMTPA did not apply to a Michigan state usury statute that limited the interest rate on an extension of an existing loan. The court found: “The DIDMCA was intended to prevent states from artificially restricting first mortgage home loan interest rates to below market rates. The provision here contains no limitation on the initial interest rate and no express limitation on a future interest rate. The DIDMCA was particularly *not* intended to preclude any other protections a state might wish to extend to borrowers.” The court also found that AMTPA only applied to loan originations, not loan extensions.
- b. *Sweeney v. Savings First Mortgage*, 388 Md. 319, 879 A.2d 1037 (2005) (DIDMCA preempts Maryland’s Finder’s Fee Law as finder’s fees are “finance charges” for DIDMCA purposes; however, DIDMCA protects only the lender, not the loan broker, so plaintiff can enforce the Finder’s Fee Law against the broker).
- c. *U.S. Bank v. Clark*, 216 Ill. 2d 334, 837 N.E.2d 74 (2005)—Illinois Interest Act Case: Homeowners argued that creditors had violated the Act by imposing fees in excess of three percent on loans with interest rates of greater than eight percent. The trial court dismissed the claims, ruling that they had been preempted by the DIDMCA, 12 U.S.C. § 1735f-7a. The Illinois Supreme Court agreed, overruling *Fidelity Financial Services, Inc. v. Hicks*, 214 Ill. App. 3d 398 (1991) to the extent its interpretation of the Illinois statute allowed for a contrary finding. Instead, the court found that the limitation in 815 Ill. Comp. Stat. Ann. 205/4.1a (2004) on lender charges was implicitly repealed by the state legislature’s 1981 amendment of 815 Ill. Comp. Stat. Ann. 205/4 (2004). Neither of the opt-out provisions in DIDMCA had been applied by the legislature as a 1992 amendment to § 4.1a did not act to readopt or revive the preempted interest and points limitation.

E. FCRA Preemption.

1. In *Woods v. Protection One Alarm Monitoring, Inc.*, 2007 U.S. Dist. LEXIS 61664 (E.D. Cal. Aug. 22, 2007) the District Court

found that FCRA preempted a state law defamation claim and that plaintiff had failed to show that defendants violated FCRA. Because the complaint “addresses conduct that clearly falls within the duties of furnishers of information” described in FCRA, plaintiffs’ defamation claim was preempted.

2. In *American Bankers Ass’n v. Gould*, 412 F.3d 1081 (9th Cir. 2005), the Ninth Circuit found that the FCRA forbids states from enacting requirements or prohibitions concerning the exchange of information between affiliates and that to the extent California’s Financial Information Privacy Act (Fin. Code §§ 4050-4060) regulates sharing of that type of information among affiliates, it is preempted. To the extent it regulates sharing of other types of information, it is not preempted.
3. But see *Apodaca v. Discover Fin. Servs.*, 417 F. Supp. 2d 1220 (D.N.M. 2006), holding that FCRA only preempts state law claims for defamation, invasion of privacy or negligence and not claims for noncompliance with other state consumer protection laws.

X. SEC LITIGATION ISSUES

Fallout from the “subprime meltdown” has resulted in a rash of securities litigation involving mortgage lenders and those involved in the issuance and rating of mortgage backed securities. Some prominent examples include:

A. Shareholder Suits Against Mortgage Lenders:

1. Countrywide Financial Corp.
 - a. *Joel Abrams v. Countrywide Financial Corp. et al.*, Case No. 2:2007cv05432, filed in the U.S. District Court, C.D. Cal., Aug. 20, 2007. Putative class action in which plaintiff is represented by Lerach Coughlin Stoia Geller Rudman and Robbins.
 - b. *George Pappas v. Countrywide Financial Corp et al.*, Case No. 2:2007cv05295, filed in the U.S. District Court, C.D. Cal., Aug. 14, 2007. Putative class action.
2. American Home Mortgage
 - a. *Massung v. American Home Mortgage Investment Corp. et al.*, Case No. 2:2007cv03350, filed in the U.S. District Court, E.D.N.Y., Aug. 13, 2007. Putative class action in which plaintiff is represented by Lerach Coughlin Stoia Geller Rudman and Robbins, and references ten other cases filed.

- b. *Blake v. American Home Mortgage Investment Corp. et al.*, Case No. 2:2007cv03237, filed in the U.S. District Court, E.D.N.Y., Aug. 8, 2007. Putative class action filed by Cohen, Milstein, Hausfeld & Toll, P.L.L.C., and references one other case filed.
3. Thornburg Mortgage
 - Slater et al. v. Garrett Thornburg et al.*, Case No. 1:2007cv00815, filed in the U.S. District Court, D.N.M., Aug. 21, 2007. Putative class action.
4. Impac Mortgage Holdings
 - Lee Tamo v. Joseph R Tomkinson et al.*, Case No. 8:2007cv00611, filed in the U.S. District Court, C.D. Cal., May 25, 2007. Derivative action, consolidated with *In Re Impac Mortgage Holdings Inc Securities Litigation*, Case No. 8:06-cv-00031-CJC-RNB, a pending putative class action.
5. Luminent Mortgage
 - a. *PEM Resources LP v. Luminent Mortgage Capital, Inc. et al.*, Case No. 3:07cv04184, filed in the U.S. District Court, N.D. Cal., Aug. 15, 2007. Putative class action.
 - b. *Greenberg v. Luminent Mortgage Capital, Inc. et al.*, Case No. 4:2007cv04141, filed in the U.S. District Court, N.D. Cal., Aug. 13, 2007. Putative class action filed by Lerach Coughlin Stoia Geller Rudman & Robbins LLP.
 - c. *Ira v. Luminent Mortgage Capital, Inc. et al.*, Case No. 3:2007cv04140, filed in the U.S. District Court, N.D., Cal., Aug. 10, 2007. Putative class action.
 - d. *Leone v. Moore et al.*, Case No. 3:2007cv04073, filed in the U.S. District Court, N.D., Cal., Aug. 8, 2007. Putative class action.
6. New Century
 - a. *The Jay Peter Kaufman Revocable Trust et al v. New Century Financial Corporation et al.*, Case No. 8:07cv00590, filed in the U.S. District Court, C.D. Cal., May 23, 2007. Putative class action filed by Milberg Weiss & Bershad LLP. Related to the following case.

- b. *Gold v. Morrice et al.*, Case No. 2:07cv00931, filed in the U.S. District Court, Feb. 8, 2007. Putative class action; references 15 member cases and 10 related cases.

7. Accredited Home Lenders

Atlas et al v. Accredited Home Lenders Holding Co et al., Case No. 3:07cv00488, filed in the U.S. District Court, S.D. Cal., Mar. 6, 2007. Putative class action brought by Lerach Coughlin Stoia Geller Rudman & Robbins LLP, and includes 5 related cases.

B. Shareholder Suits Against Investors/Financiers in Mortgage Companies:

- 1. *Charlotte H. Collums Living Trust Dated 1/22/97 v. RAIT Financial Trust et al.*, Case No. 2:07cv03574, filed in the U.S. District Court, E.D. Pa., Aug. 28, 2007. Putative class action alleging that RAIT, a real estate investment trust, informed shareholders for the first time on July 31 that RAIT had a net equity exposure of \$95 million, or \$1.56 per share, in American Home Mortgage as a result of providing trust preferred financing and that RAIT's share price fell by 40 percent on the news. References seven other cases filed, including
- 2. *Stolpestad v. RAIT Financial Trust*, Case No. 2:2007cv03236, filed in the U.S. District Court, E.D. Pa, Aug. 8, 2007. Same allegations as above.

C. Bond Investor Suits Against Issuers of MBS/ABS (and Others):

- 1. Credit Suisse
 - a. *Bankers Life Insurance Co. v. Credit Suisse First Boston Corp. et al.*, Case No. 8:2007cv00690, filed in the U.S. District Court, M.D. Fla., Apr. 23, 2007. Bankers Life sued Credit Suisse ("CSFB"), the issuer and underwriter of certain mortgage backed securities, DLJ, an affiliate who sold the mortgage loans that were pooled to create the MBS collateral, as well as the servicer of the loans, the trustee under the Pooling & Servicing Agreement, and Triad Guaranty Insurance Corp., for, among other things, securities law violations and state law claims of negligent misrepresentation, fraud, breach of fiduciary and conspiracy.
 - i. Bankers Life alleged that CSFB misrepresented that the MBS were "'safe,' minimum risk, fixed income products" and that the mortgage loans had been

purchased from “highly credible financial institutions.” The mortgage loans were instead allegedly originated with inadequate underwriting and by originators who engaged in improper lending practices. When the credit ratings of the MBS were downgraded, Bankers Life lost over \$1.2 million. Furthermore, CSFB failed to enforce the representations and warranties made by DLJ in connection with the sales of the mortgages.

ii. Bankers Life filed an amended complaint on August 27, 2007, which dropped its securities law claim against CSFB but added claims for breach of contract against various parties.

iii. Note that this action pre-dates the more recent downgrades of numerous MBS and ABS by the rating agencies.

b. Two other similar cases have since been filed by the same law firm: *Americantrust Federal Savings Bank et al v. Credit Suisse First Boston Corporation et al.*, Case No. 3:07cv00302, filed in U.S. District Court, N.D. Ind., July 2, 2007, and *Sterling Federal Bank, F.S.B. v. Credit Suisse First Boston Corporation et al*, Case No. 1:07cv02922, filed in the U.S. District Court, N.D. Ill., May 24, 2007.

D. Shareholder Suits Regarding Rating Agency Activities:

1. *Reese v. Bahash*, Case No. 1:2007cv01530, filed in the U.S. District Court, D.D.C., Aug. 28, 2007. Putative class action for breach of fiduciary duty against the CFO and EVP of McGraw-Hill, alleging that McGraw Hill made false statements regarding its financial results based on its failure “to fully disclose that the Company’s Standard & Poor’s subsidiary assigned excessively high ratings to bonds backed by risky subprime mortgages . . . which was materially misleading to investors concerning the quality and relative risk of these investments.” News thereafter that the EU intended to examine the rating agencies caused McGraw Hill’s stock to fall by 5%.

E. SEC Fraud Action:

1. *SEC v. First Bancorp*, Case No. 1:2007cv07039, filed in the U.S. District Court, S.D.N.Y., Aug. 7, 2007. SEC accused First Bancorp of concealing from auditors and from the public the true nature of more than \$4 billion in mortgage-related transactions from 2000

through 2005. “Former senior managers” of First Bancorp are accused of directing a scheme that brought “over \$100 million in net interest income at little or no risk” by “purportedly purchasing mortgages” from Doral Financial Corp., which also is alleged to have “improperly recognized income on these transactions.” The SEC claims that “former First Bancorp senior management also created and backdated certain documents and affirmatively misrepresented the terms of certain mortgage-related transactions to its independent auditor to avoid a restatement in November 2004.” Most of the mortgages loans at issue “were non-conforming residential mortgages.”

2. Final judgment by consent entered on Aug. 21, 2007, including a civil penalty of \$8.5 million against First Bancorp to be paid within 45 days and permanent injunction against future securities law violations.

XI. STATE LAW UPDATE

A. Do-Not-Fax Class Actions

1. Series of 30+ class actions filed in Oklahoma.
2. Claim is based on alleged violation of the Telephone Consumer Protection Act (“TCPA”). Plaintiff alleges that defendant sent unsolicited advertisements, via facsimile. Plaintiff seeks a State-only class to avoid CAFA issues.
3. The statute of limitations under the TCPA is four years. 28 U.S.C. § 1658.
4. The TCPA is essentially a strict liability statute. A recipient of an unsolicited fax advertisement has a claim under the TCPA for statutory damages as well as injunctive relief. If a company sends an unsolicited advertisement, it can be held liable for a flat statutory \$500 penalty per violation. In addition, if the company is found to have violated the TCPA intentionally, then the penalty can be increased up to \$1,500, at the discretion of the Court. 47 U.S.C. § 227(b)(3).
5. There are three main defenses to a TCPA claim:
 - a. The defendant can show that the fax was not “unsolicited”—i.e., that the recipient had previously consented. 47 U.S.C. § 227(a)(4).

- b. The defendant can show that it had an Existing Business Relationship (EBR) with the recipient. 47 U.S.C. § 227(a)(2) (Supp.2006); 47 C.F.R. § 64.1200(f)(5).
 - c. TCPA creates State cause of action. If State has not opted in to the TCPA, then no cause of action lies. 47 U.S.C. § 227 (b)(3).
6. Oklahoma wave apparently triggered by *Lampkin v. GGH, Inc.*, 146 P.3d 847 (Okla. App. 2006). In that case, the Court of Appeals reversed a trial court’s decision to deny class certification of a TCPA claim. In reaching this conclusion, the Court of Appeals held that (1) plaintiff’s class definition of all persons who received “unsolicited faxes” was sufficient; and (2) it was defendant’s burden to prove that each recipient either previously consented to the fax advertisements or had an EBR.

B. Foreign Language Disclosure Class Actions

- 1. Putative Class Action filed in California Federal Court based on alleged violation of California Civil Code §1632.
- 2. Civil Code § 1632(b) provides that, if a loan is “negotiated primarily” in one of the five specified foreign languages (Spanish, Chinese, Vietnamese, Tagalog, or Korean), that loan may be rescinded if the lender fails to provide the borrower foreign language translations of the loan documents.
- 3. Exception: borrower provides own non-minor translator. Civil Code § 1632(h).
- 4. Subsequent documents that “substantially affects” customer’s rights must also be translated. *Reyes v. Superior Court*, 118 Cal.App.3d 159, 162 (1981).
- 5. If a loan is found to be in violation, the loan may be rescinded, even if it was assigned to a third party. In such cases, the assignor is required to “promptly repurchase” the loan from the assignee. Civil Code § 1632(k).
- 6. Limited application – depends on license. Civil Code § 1632(b)(4).
- 7. No attorney’s fee provision. However, violation of Civil Code § 1632 may trigger liability under other consumer protection statutes.

C. Recent Developments in State Consumer Protection Case Law

1. California's Unfair Competition Law – Business & Professions Code § 17200, *et seq.* (“UCL”).

a. Standing Required. Post-Prop 64 UCL permits class-wide relief only if the plaintiff can obtain class certification. Moreover, the plaintiff must have standing to bring the claim—i.e., he/she must have suffered monetary or property loss as a result of defendant's alleged misconduct. *Californians for Disability Rights v. Mervyn's LLC* 39 Cal.4th 223, 227 (2006).

i. *Arias v. Superior Court*, 153 Cal.App.4th 777 (2007). Re-confirms that a UCL representative action must be brought as a class action in compliance with Code of Civil Procedure § 382.

ii. *McAdams v. Monier, Inc.*, 151 Cal.App.4th 667 (2007). Held that plaintiffs lacked standing to assert either a UCL or a CLRA claim. Standing under the UCL exists if plaintiff:

(a) Expended money due to the defendant's acts of unfair competition (e.g., plaintiff incurred costs due to defendant's unauthorized release of private information);

(b) Lost money or property (e.g., plaintiff's home vandalized); or

(c) Been denied money to which he or she has a cognizable claim (e.g., defendant terminated plaintiff's disability benefits).

b. UCL Enables Fraud Class Actions? Despite the passage of Prop 64, the UCL is still viable and useful to a plaintiff. The benefits of a UCL claim include: (1) it permits a plaintiff to enforce a right where he/she otherwise has no cause of action; (2) it permits the plaintiff's attorney to seek attorney's fees under Civil Code § 1021.5; and (3) it may permit a plaintiff to pursue a fraud/misdisclosure claim on a class basis.

i. *McAdams v. Monier*, 151 Cal.App.4th 667 (2007)

(a) Filed as UCL / CLRA fraud claim “based on a single, specific, alleged material

representation.” Claim was that defendant knew but failed to disclose a material fact to consumers.

- (b) Held: the UCL standard is “likely to deceive” and “in this context, class treatment is appropriate.” Reliance could be presumed and variations in damages are not enough to defeat class certification.
 - ii. Note: defendant has appealed the *McAdams* case and California Supreme Court has until October to decide whether to grant review. It is likely that it will do so since *McAdams* raises the same “presumption of reliance” issue that was the heart of *Pfizer, Inc. v. Superior Court*, 141 Cal.App.4th 290 (2006) and *In re Tobacco II Cases*, 142 Cal.App.4th 891 (2006), which are both already under review.
- c. Affirmative Defenses Can Defeat Class Certification. *Walsh v. IKON Office Solutions, Inc.*, 148 Cal.App.4th 1440 (2007).
- i. Evidence presented on decertification motion showed significant variation in facts crucial to deciding whether an account manager was an exempt “outside salesman.”
 - (a) amount of time spent outside the office
 - (b) whether the manager engaged in sale-related activities while outside the office
 - ii. Uniform job description not enough where the way subclass members discharged their duties varied considerably.
 - iii. Deliberate misclassification not enough where facts show that some employees were misclassified and others were not.
 - iv. *Sav-On Drug Stores* does not require certification of wage and hour claims over the outside salesman defense; it leaves the matter to trial court discretion.
- d. Equitable Defenses Alone May Not Defeat Class. Even though equitable defenses may cause variations among a

class member's scope of recovery, the existence of such defenses are not sufficient to defeat certification.

- i. *Ticconi v. Blue Shield of California Life & Health Ins. Co.*, 153 Cal.App.4th 1123 (2007) held: “[t]he fact that class members must individually demonstrate their right to recover, or that they may suffer varying degrees of injury, will not bar a class action; nor is a class action precluded by the presence of individual defense against class plaintiffs.”
 - ii. “[E]quitable defenses may not be asserted to wholly defeat a UCL claim [under Bus. & Prof. Code, § 17200] since such claims arise out of unlawful conduct. . . .” *Cortez v. Purolator Air Filtration Products Co.*, 23 Cal.4th 163, 179 (2000).
- e. UCL Safe Harbor Rules clarified (again). *Fladeboe v. American Isuzu Motors, Inc.*, 150 Cal.App.4th 42 (2007) clarifies that the *Cel-Tech* safe harbor exist only if the Legislature has affirmatively determined that a particular act is lawful.
- i. “Acts that the Legislature has determined to be lawful may not form the basis for an action under the unfair competition law, but acts may, if otherwise unfair, be challenged under the unfair competition law even if the Legislature failed to proscribe them in some other provision.”
- f. Discovery for Pre-Certification Communications. While not authorized by statute, case law recognizes that pre-certification discovery is not automatically objectionable.
- i. *Atari, Inc. v. Superior Court*, 166 Cal.App.3d 867, 871 (1985); *Howard Gunty Profit Sharing Plan v. Superior Court*, 88 Cal.App.4th 572, 580 (2001); *Parris v. Superior Court*, 109 Cal.App.4th 285, 290, 292-293, 295-300 (2003).
 - ii. Recent decisions have, in fact, permitted plaintiffs to conduct discovery to ascertain the identity of the putative class members. These cases have rejected defendants' argument that the putative class members' identities may not be disclosed because

they are absolutely protected by the Constitutional Right to Privacy.

- iii. *Pioneer Electronics (USA), Inc. v. Superior Court*, 40 Cal.4th 360, 375 (2007). California Supreme Court affirmed trial court's decision to permit plaintiffs' counsel discovery to ascertain identity of putative class members (who complained about the product at issue), subject to giving them notice and opportunity to object to disclosure—i.e., affirmative consent was not required.
 - iv. *Belaire-West Landscaping, Inc. v. Superior Court*, 149 Cal.App.4th 554 (2007). Extended *Pioneer* rule to employment litigation.
2. California's Consumer Legal Remedies Act – Civil Code § 1750, *et seq.* (“CLRA”).
- a. Considered by many plaintiffs' attorneys to be an alternative to the UCL—especially post-Prop 64.
 - b. Permits plaintiffs to recover damages, including punitive damages. Civil Code § 1780(a).
 - c. Requires plaintiff to give defendant notice before filing suit for damages.
 - i. Lack of pre-filing notice is grounds to dismiss all prayers for damages. *Outboard Marine, Corp. v. Sup. Ct.*, 52 Cal.App.3d 30 (1975); *Von Grabe v. Sprint PCS*, 312 F.Supp.2d 1285, 1304 (S.D. Cal. 2003).
 - ii. Note: pre-filing notice may be sufficient to justify attorneys' fee claim under the “catalyst theory.”
 - (a) *Graham v. DaimlerChrysler Corp.*, 34 Cal.4th 553 (2004).
 - (b) *Trew v. Volvo Cars of North America, LLC*, E.D. Cal., Civ. No. S-05-1379 RRB EFB (order filed July 31, 2007).
 - iii. Limited in scope. Recent case law have held that the CLRA does not apply to credit transactions—such as loans—because loans are not “goods” nor “services.”

- iv. *Berry v. American Express Publishing, Inc.* (2007) 147 Cal.App.4th 224. Held that the extension of credit is not a “service,” especially when it is an extension of credit unconnected to a specific sale or lease transaction.
 - v. *Fairbanks v. Superior Court*, ___ Cal.App.4th ___ (Aug. 23, 2007). Held that insurance is not a “good” or a “service” within the meaning of the CLRA. In so doing, acknowledged legislative history and inherent limitation of the CLRA, and cited *Berry v. American Express Publishing, Inc.* (2007) 147 Cal.App.4th 224 favorably.
- d. But: “good” and “services” limitation not uniformly interpreted by Federal Courts.
- i. Pro: *Van Slyke v. Capital One Bank*, 2007 WL 1655641 (N.D. Cal. Jun. 7, 2007).
 - ii. Pro: *Augustine v. FIA Card Servs, N.A.*, 485 F.Supp.2d 1172 (E.D. Cal. 2007).
 - iii. Con: *Jefferson v. Chase Home Finance LLC*, 2007 WL 1302984 (N.D. Cal. May 3, 2007).
3. Developments in Predatory Lending and Servicing.
- a. Plaintiffs’ attorneys have been and are still in search of a claim. Some (many) have tried the “spaghetti on the wall” approach. See e.g., *In re: Ocwen Loan Servicing, LLC Mortgage Servicing Litigation*, ___ F.3d ___ (7th Cir. June 22, 2007). While not getting much traction, these cases are still around and simmering.
 - b. Refusal to make loans based on the applicant’s “source of income” may be sufficient to sustain discrimination and unfair competition claims. In *Sisemore v. Master Financial, Inc.*, 151 Cal.App.4th 1386 (2007), the defendant had policy of not lending to home day care operators. Court held that plaintiff properly alleged a claim for intentional discrimination under FEHA in two ways: (1) discrimination on the source of income in violation of subdivision (e) of section 12955; and (2) allegation of a prima facie case of disparate impact discrimination on two protected classes, namely, women and families with children, in violation of subdivision (e) of section 12955.

4. One-Way Intervention Problem Resolved.
 - a. The one-way intervention problem has been described as “being pecked to death by ducks.” Since a putative class is not bound by an adverse decision against the class representative, a defendant could face a situation where one plaintiff would bring motion to adjudicate a merits issue, lose, then another would bring suit. This process could be repeated until one plaintiff eventually prevails, and then “everyone else would ride on that single success.”
 - b. In *Fireside Bank v. Superior Court (Gonzalez)*, 40 Cal.4th 1069 (2007), the California Supreme Court put an end to this possibility. Now, as in Federal Court, plaintiffs pursuing class actions in California must seek resolution of the class certification question first, before bringing a motion to adjudicate a merits issue. That way, if the plaintiff loses the merits motion, the decision will bind the entire class.

XII. EMPLOYMENT LITIGATION UPDATE

- A. Fair Labor Standards Act claims are on the increase and the results are mixed.
 1. *Olivo v. GMAC Mortgage Corp.*, 374 F. Supp. 2d 545, 549-50 (E.D. Mich. 2004) holds that GMAC’s loan officers are exempt from FLSA overtime pay requirements as “outside salesmen.”
 2. *Belton v. Premium Mortgage, Inc.*, 2006 WL 561489 (W.D. Mo. 2006) (holding loan officers were not exempt as “outside salesmen”).
 3. *Gatto v. Mortgage Specialists of Illinois, Inc.*, 442 F.Supp.2d 529 (N.D. Ill. 2007) holds that mortgage brokerage was within “retail or service” establishment exemption from overtime under FLSA where it did not do any direct lending.
 4. *Saunders v. Ace Mortgage Funding, Inc.*, 2007 WL 1190985 (D. Minn. 2007) holds that mortgage brokerage was not within “retail or service” establishment exemption from overtime under FLSA where it did some direct lending and was licensed to lend in 13 states.
 5. *Pontius v. Delta Financial Corp. d/b/a Fidelity Mortgage Inc.*, No. 04-1737 (W.D. Pa. 2007) (distinguishing facts in Dept. of Labor’s opinion letter, judge dismissed argument that mortgage loan

officers fell under FLSA's overtime exemption for "retail or service" establishments).

6. Dept. of Labor, Employment Standard Administration March 31, 2006 letter to National Association of Mortgage Brokers, interprets regulations to allow treatment of outside loan sales representatives as exempt outside salespeople "if they are 'customarily and regularly engaged away from their employer's place of business in obtaining mortgages from brokers and individuals.'"
7. Dept. of Labor, Employment Standards Administration September 8, 2006 letter interprets regulations to allow treatment of mortgage loan officers as exempt administrative employees.
8. Settlements in wage and hour litigation involving loan/account personnel.
 - a. *Butler v. Countrywide Home Loans, Inc.*, No. BC 268250, (California Superior Court, Los Angeles County).
 - b. *Cox v. Downey Sav. & Loan Ass'n*, No. BC 318964, (California Superior Court, Los Angeles County).
 - c. *Casas v. Conseco Finance Corp.*, No. Civ. 00-1512 (JRT/SRN) (D. Minn.): \$11 million settlement with class of 2,700 loan officers (later reduced in bankruptcy).

B. FLSA/State Law Wage and Hour Cases Pose Unique Class Action Problems.

1. The Portal-to-Portal Act amended the FLSA in 1947 to lessen employer liability by requiring, among other things, opt-in classes. Each plaintiff must affirmatively consent in writing to litigation on his or her behalf. 29 U.S.C. § 216(b).
 - a. FLSA class certification generally follows a two-step procedure. *See, e.g., Epps v. Oak Street Mortgage, LLC*, 2006 WL 1460273 (M.D. Fla. 2006); *Stanfield v. First NLC Financial Servs., Inc.*, 2006 WL 3190527 (N.D. Cal. Nov. 1, 2006), citing *Leuthold v. Destination America, Inc.*, 224 F.R.D. 462, 466 (N.D. Cal. 2004).
 - b. First step: Early in litigation plaintiff moves for conditional certification and notice to class members of right and need to opt in. At this stage, the plaintiff need only make a minimal showing by allegation (and, perhaps, some evidence) that plaintiff and class members are "similarly situated" in being "victims of a single decision,

policy or plan.” The burden is light, and typically the class is conditionally certified. *Scott v. Heartland Home Finance, Inc.*, 2006 WL 1209813 (N.D. Ga. 2006) (granting conditional class certification to class of loan officers); *Stanfield*, 2006 WL 3190527 at *2 (granting conditional class certification to class of loan officers, loan processors and account managers), citing *Leuthold*, 224 F.R.D. at 467; *Davis v. Novastar Mortgage, Inc.*, 408 F. Supp. 2d 811, 815 (W.D. Mo. 2005); *Chabrier v. Wilmington Finance, Inc.*, 2006 WL 3742774 (E.D. Pa. 2006) (conditionally certifying class of loan officers but only in Cincinnati office, not nationwide, because plaintiffs only submitted evidence from employees in that office).

- c. Second step: After discovery, the employer may move to decertify the class. At this stage, the court determines propriety and scope of class, considering (i) disparate factual and employment settings of individual employees, (ii) various defenses available to employer as to individual employees, and (iii) fairness and procedural considerations. *Leuthold*, 224 F.R.D. at 467; *Epps*, 2006 WL 1460273 at *3 (denying defendant’s motion to decertify class of loan officers).
 - d. Typically, the opt-in rate for FLSA actions is 15-30% of the certified class, although the rate may be higher in union-backed suits. See Matthew Lampe & E. Michael Rossman, *Procedural Approaches for Countering the Dual-Filed FLSA Collective Action and State-Law Wage Class Action*, 20 Lab. Law. 311, 313 (2005).
2. State law claims are subject to normal opt-out class action procedure under Federal Rule of Civil Procedure 23(b)(3). Opt-out rates are typically low. Plaintiffs, therefore, often combine state law claims with FLSA claims to obtain the benefits of both: FLSA liquidated damages and attorney fees with an opt-out class for the state law claims.
 3. Employer counter-strategies begin with removal of the case to federal court, see *Breuer v. Jim’s Concrete of Brevard, Inc.*, 58 U.S. 691 (2003), followed by:
 - a. A motion to dismiss non-opt-in class members on the ground that the court lacks supplemental jurisdiction over them. See *Bartelson v. Winnebago Indus., Inc.*, 219 F.R.D. 629 (N.D. Iowa 2003). The downside to this strategy is that the dismissed employees may refile in state court.

- b. A motion to dismiss non-opt-in class members on the ground that the court should exercise its discretion to decline supplemental jurisdiction over them because state law claims predominate or there are other compelling reasons to decline jurisdiction. 28 U.S.C. § 1367(c); *McClain v. Leona's Pizzeria, Inc.*, 222 F.R.D. 574, 577 (N.D. Ill. 2004) (declining supplemental jurisdiction over state law opt-out class claims because it would undermine Congress's intent to establish an opt-in scheme for FLSA collective actions); *De Asencio v. Tyson Foods, Inc.*, 342 F.3d 301 (3d Cir. 2003). Same downside: dismissed employees may refile in state court.

- c. An opposition to Rule 23 class certification on the ground that:
 - i. Rule 23(a)'s numerosity requirement cannot be met since joinder of all class members is possible using the FLSA opt-in procedure. *See, e.g., Thiebes v. Wal-Mart Stores, Inc.*, 2002 WL 479840 (D. Or. 2002).

 - ii. Rule 23(b)(3)'s superiority requirement cannot be met. Those employees who want to participate can do so by opting in. Class members may be confused by being asked to opt in and opt out at the same time. *McClain, supra*, 222 F.R.D. at 577; *Muecke v. A-Reliable Auto Parts & Wreckers, Inc.*, 2002 WL 1359411 (N.D. Ill. 2002); *Leuthold, supra*, 224 F.R.D. at 470; *but see Breeden v. Benchmark Lending Group, Inc.*, 229 F.R.D. 623, 628-31 (N.D. Cal. 2005) (certifying Rule 23 class solely on issue of whether loan officers were properly classified as exempt employees).

 - iii. In cases alleging misclassification of a class of employees as exempt from overtime laws, Rule 23(b)(3)'s predominance of common questions requirement is not met because individualized inquiries into each putative class member's daily work activities is necessary. *See, e.g., Dunbar v. Albertson's, Inc.*, 141 Cal.App.4th 1422 (2006) (denying certification of class of store managers); *Walsh v. Ikon Office Solutions, Inc.*, 148 Cal.App.4th 1440 (as modified March 28, 2007) (decertifying class of account managers); *see also Williams v. Accredited Home Lenders, Inc.*, 2006

WL 2085312 (N.D. Ga. 2006) (denying certification of class of loan officers claiming they were forced to work off-the-clock on ground that individualized inquiries predominated).

- iv. If Rule 23 class certification is denied in the federal suit, does that ruling prevent class certification in a later-filed state-court, state-law-only claim on behalf of the same employee class? Surprisingly, the answer may be “yes.” *See In re Bridgestone/Firestone, Inc. Tires Prod. Liab. Litig.*, 333 F.3d 763, 766-67 (7th Cir. 2003).

C. Prosecution of FLSA violations as “unfair business practices” under the UCL.

- 1. The UCL prohibits “unlawful” business practices—i.e., any business practice that violates some other law, such as the FLSA.
- 2. Advantages to UCL add-on claim:
 - a. Statute of Limitations.
 - i. The FLSA provides for a two-year limitations period unless the violation is willful, in which case a three-year period applies. 29 U.S.C. § 255(a).
 - ii. The UCL provides for a four-year limitations period. Cal. Bus. & Prof. Code § 17208. The longer period for which unpaid wages may be recovered under the UCL is so favorable to employees that plaintiff’s lawyers who neglect to include a UCL claim may be committing malpractice. *See Janik v. Rudy, Exelrod & Zieff*, 119 Cal.App.4th 930, 943 (2004) (reversing dismissal of malpractice lawsuit; plaintiffs’ attorneys had duty to consider and communicate to plaintiffs advantages and disadvantages of seeking to add UCL cause of action to overtime class action).
 - iii. *Bahramipour v. Citigroup Global Markets, Inc.*, 2006 WL 449132, at *3-4 (N.D. Cal. 2006), holds that FLSA does not preempt UCL add-on claim or its longer limitations period. *Accord Barnett v. Washington Mut. Bank*, 2004 WL 2011462 (N.D. Cal. 2004).

- b. Opt-out Class.
 - i. The FLSA allows only opt-in classes. 29 U.S.C. § 216(b).
 - ii. A regular Rule 23 opt-out class may be certified for a UCL claim.
 - iii. Cases holding that the FLSA does not bar opt-out class certification of UCL claims predicated on FLSA violations: *Harris v. Investor's Business Daily, Inc.*, 138 Cal. App. 4th 29 (2006); *Bahramipour*, 2006 WL 449132, at *4-5; *Takacs v. A.G. Edwards & Sons, Inc.*, 444 F.Supp.2d 1100, 1118 (S.D. Cal. 2006); *Tomlinson v. IndyMac Bank, F.S.B.*, 359 F. Supp. 2d 898, 901 (C.D. Cal. 2005); *Barnett*, 2004 WL 2011462, at *6-7; *Kelly v. SBC, Inc.*, 1998 U.S. Dist. LEXIS 18643, at *38 (N.D. Cal. 1998).
 - iv. Also, the California Supreme Court has granted review of *Mills v. Superior Court* (2006) 135 Cal.App.4th 1547, which had held that Labor Code § 226.7(b)'s imposition of liability for an additional hour's pay when the employer fails to allow mandated meal and rest time is a statutory penalty and, so, not enforceable through 17200 and not subject to additional penalties for delay in payment of wages. Briefing in *Mills* was deferred pending the decision in *Murphy v. Kenneth Cole Productions, Inc.*, 40 Cal.4th 1094 (2007), in which the Supreme Court held that the additional hour's pay is "wages," not a "statutory penalty" for statute of limitations purposes. The *Murphy* holding is likely to be applied in *Mills*, which would mean employees may file a UCL suit for relief under Labor Code § 226.7(b) and take advantage of the UCL's four-year statute of limitations.
3. Disadvantage of the UCL add-on claim: limited relief.
 - a. In a private UCL action, the plaintiff may recover only an injunction and restitution of money "which may have been acquired by means of such unfair competition." Damages and penalties are not recoverable in a UCL action. Cal. Bus. & Prof. Code § 17203; *Korea Supply Co. v. Lockheed Martin Corp.*, 29 Cal. 4th 1134, 1144 (2003).

- b. Restitution, however, allows the plaintiff to recover money in which he or she has a vested interest, even if the money was never in his or her possession. Earned but unpaid wages, in particular, can be the subject of restitution under this rationale. *Cortez v. Purolator Air Filtration Prods. Co.*, 23 Cal. 4th 163, 178 (2000).
- c. What sums are subject to restitution in a UCL add-on claim?
 - i. Liquidated damages under the FLSA are not “penalties” but are not recoverable in a UCL add-on claim because they are awarded in addition to the amount of unpaid wages. *Tomlinson v. IndyMac Bank*, F.S.B., 359 F. Supp. 2d 891, 897 (C.D. Cal. 2005).
 - ii. Waiting time penalties under California Labor Code section 203 are penalties and not recoverable in a UCL action. *Tomlinson*, 359 F. Supp. 2d at 895.
 - iii. Extra hour’s pay, Cal. Lab. Code § 226.7(b), for violation of rest and meal break laws is earned wage and is recoverable in a UCL action. *Tomlinson*, 359 F. Supp. 2d at 896. (Decision will likely be followed by California Supreme Court, assuming its ruling in *Mills v. Superior Court*, *supra*, follows its *Murphy v. Kenneth Cole Productions*, *supra*, decision.)

XIII. BANKRUPTCY AND SERVICING LITIGATION UPDATE

- A. Bankruptcy Attorneys’ Fees Class Action.
 - 1. Putative class action against lender defendant for attempting to recover attorneys’ fees incurred in obtaining relief from bankruptcy automatic stay.
 - 2. Original suit was based on alleged violation of the FDCPA and the bankruptcy laws (i.e., 11 U.S.C. § 506(b) and Fed. R. Bankr. P. 2016(a)). Plaintiff argued that trust deed beneficiary is barred from charging attorney fees incurred in connection with bankruptcy without “first getting an order from the bankruptcy court awarding it such fees.” Claims dismissed, and plaintiff amended complaint.
 - 3. Amended complaint alleges that defendants’ right to collect attorney fees is governed by State law. Plaintiff argued that

defendants violated California Civil Code § 1717 and § 1021, by collecting attorney fees without proper notice, without establishing a right to recover the fees, and for motions that were unnecessary (i.e., it was not necessary for defendant to seek relief from the automatic stay).

4. Case has survived the pleadings stage and is now in discovery.

B. MERS' Rights As Nominee.

1. Individual and putative class actions have been filed to challenge MERS' right to foreclose on property as nominee of the lender.
2. *Trent v. Mortgage Electronic Registration Systems, Inc.*, No. 3:06-cv-374 (M.D. Fla. July 20, 2007). Court held that lender was aware of MERS' role as nominee and, hence, there was no misrepresentation.
3. *Mortgage Electronic Registration Systems, Inc. v. Azize*, ___ So.2d 2007 WL 51 7842 (Fla.2d DCA, February 21, 2007) and *Mortgage Electronic Registration Systems, Inc., v. Revoredo*, 955 So.2d 33 (Fla.3d DCA, 2007). Confirms that MERS has standing to foreclose as nominee for lender.
4. Issue still unresolved in California.

C. No Shortcuts

1. *In re Rivera*, 342 B.R. 345 (Bankr. D.N.J. 2006). Held that law firm's use of "pre-signed" certifications in support of relief from automatic stay was violation of bankruptcy rules and grounds for the imposition of sanctions.
2. "Mortgage-secured parties, their servicers and subservicers, and attorneys, are admonished that in this district stay relief applications to advance foreclosures (and particularly residential real estate foreclosures) must comply with local rules. Nothing less than such compliance, diligent inquiry and accurate accounting will be accepted. Future lapses in process will be dealt with accordingly."
3. "The court depends on the ethical and professional conduct of attorneys. As volume increases, judicial processes and participants are subjected to certain pressures. Electronic filing and retrieval are necessary court aids, but dependable, ethical performance by lawyers remains indispensable. Lawyers must maintain their independence – and resist, at the risk of losing a client or their

employment, pressures which would undercut their professionalism.”