

# LITIGATION AND ENFORCEMENT UPDATE:

RESPONDING TO ENFORCEMENT ACTIONS  
AND RESPA LITIGATION DEVELOPMENTS

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September 15, 2008

# ENFORCEMENT: PART I

## OVERVIEW

- The collapse of the secondary mortgage market and the current foreclosure and credit crises have spawned countless investigations and lawsuits
- Federal, state, and local governments are all responding aggressively
- Among the targets of these investigations are lenders, brokers, servicers, homebuilders, appraisers, title companies, and the investment banks that packaged and sold mortgage-backed securities
- In other words, everyone...

- The FBI reports 1,380 ongoing mortgage fraud probes, including corporate fraud investigations of 21 corporate targets
- The SEC is investigating suspected cases of securities fraud and alleged misrepresentations made in SEC filings regarding lenders' financial positions and the quality of their mortgage loans
- The Justice Department has sued Countrywide in Florida, Georgia and Ohio, alleging abuse and mismanagement of bankruptcy and foreclosure processes

- AGs in a number of states have launched investigations and/or commenced lawsuits
- AG Cuomo (NY) is examining whether investment firms properly disclosed to investors the risk that many of the underlying mortgages for mortgage-backed securities could suffer high default rates
- AG Milgram (NJ) filed three civil lawsuits charging numerous mortgage companies, real estate brokers, title companies, attorneys and appraisers with consumer fraud and racketeering
- AGs in California, Connecticut, Florida, Illinois, and Indiana have all brought suits against Countrywide alleging unfair and deceptive lending practices

- State regulators are taking their lead from federal investigators and responding to consumer complaints and the growing foreclosure crises in many states
- Investigations into lending issues, including affiliated business arrangements, servicing issues and foreclosure-related issues
- State licensing entities have imposed increased scrutiny on current licensees as well as new applicants
- Some states are asking lenders and servicers to sign “compacts” regarding the principles to govern loan workouts for consumers facing foreclosure

- Increasingly, whistleblower complaints are the impetus for government investigations
- The massive amount of publicity regarding mortgage fraud emboldens disgruntled employees to start talking
- YouTube and the Internet are resources for disgruntled employees as well as tools for widespread dissemination of complaints

ENFORCEMENT: PART II

RESPONDING TO

AN ENFORCEMENT ACTION

- Your Company receives notice of a federal, state, or local enforcement action
  - Formal: service of a subpoena or lawsuit
  - Informal: a “request for information” from a state or federal regulator
- What steps should you take to ensure the best possible outcome?

## Formal Actions:

- Rely on counsel for advice on responding to specific requests and allegations
- Examples
  - AG Subpoenas – counsel can work with the AG’s office to limit topics or revise areas of inquiry to make compliance more feasible
  - DOJ/HUD Complaints – counsel can prepare responses and assert appropriate defenses
  - Audits – counsel can coordinate the information-gathering process and assist with preparation of the audit response

## Informal Actions:

- Be wary of “informal” requests for information
- One thing can lead to another
- Examples
  - Maryland receives a consumer complaint regarding a servicer’s alleged failure to post payments. As part of the inquiry, Maryland asks the lender for its file and then ends up pursuing an action against the lender for alleged improper disclosures
  - You are asked by a regulator to respond to a “best interest of the industry” survey. Should you respond or not? What if it triggers an investigation of your company?

## STEP 2: HOW SHOULD YOU SAY IT?

- Consider the implications of your response
- Examples
  - You respond to an audit for a state regulator, but are wondering what your obligations are to the other states where you are licensed. And will notifying the other states lead to inquiries or audits from them?
  - You are faced with an AG or HUD lawsuit. Who do you need to notify about the action? State regulators, insurance carriers, others?
  - Consider the potential for criminal liability for you and your employees. Remember, it is a crime to lie to an investigator (i.e., obstruction of justice)

- What will be the outcome – win, lose, settle?
- Should you enter into a settlement or consent decree?
- Advantages:
  - If the facts are bad, you can negotiate for imposition of a lesser fine or civil money penalty
  - You may be able to keep the resolution confidential, although this is less likely if the government is under pressure to publicize results
  - Time and resources can be directed towards more productive endeavors for the company

- Potential Pitfalls of Settlements:
  - Multiple agency settlements: the order in which you enter into settlements with multiple agencies (whether federal, state, or both) can make a difference
  - Example: you decide to settle an inquiry brought by the SEC, but the consent decree has you admitting to certain conduct which may violate a statute or be deemed an admission of liability with respect to your defense of a class action case
  - You voluntarily agree to pay a fine to a state regulator in connection with the resolution of an investigation. Must you now report that fine to other states?

RESPA ENFORCEMENT  
AND  
RESPA LITIGATION DEVELOPMENTS

- RESPA claims have been with us for a long time
- They are pursued both as HUD enforcement actions as well as private litigation
- Most private lawsuits are brought as class actions

- HUD has settled its enforcement action against certain real estate brokerages (Realty, RE/MAX, and Pickford Realty d/b/a Prudential California) and Property I.D. Corporation, a provider of natural hazard disclosure reports (“NHD reports”). The suit alleged that LLCs formed by the companies were not bona fide affiliated business arrangements but instead were created to provide kickbacks to the real estate brokers.
- As part of the settlement, Property I.D. has voluntarily agreed to treat the provision of NHD reports (a California state law requirement) as a settlement service subject to RESPA, a position long asserted by HUD.
- Another significant aspect of the HUD case was an interim court ruling that HUD has the authority to seek disgorgement of alleged illegal profits.
- In addition to the HUD settlement, the related case of *Berger v. Property I.D.* also settled following the court’s grant of class certification. Terms of settlement include the payment of \$40 million.

# RESPA LITIGATION DEVELOPMENTS

1. Homebuilder “Required Use” Cases - Homebuilders offer discounts and rebates on sales prices, upgrade packages, or closing costs, on the condition that the homebuyers use the affiliates’ settlement services. Plaintiffs argue that these incentives constitute “required use,” thereby precluding the builders and their affiliates from relying on RESPA’s affiliated business arrangement exemption. Three district court rulings in favor of the builders are on appeal.
2. Captive Title Insurance - A lender agrees to use a certain title insurance company and, in exchange, the title insurance company agrees to reinsure the title policy with the lender’s captive title reinsurance affiliate. Recent HUD settlements based on assertion that “little or no risk” transferred for payment.
3. Captive Mortgage Insurance - Plaintiffs assert that lenders and private mortgage insurance companies have attempted to circumvent RESPA’s prohibition on kickbacks by arranging to have mortgage insurance policies reinsured by a captive affiliate of the lender. Despite plaintiffs’ claim of no assumption of risk, it is anticipated that reinsurers will be on the hook for losses, given the rise in mortgage defaults. HUD has not pursued these cases presumably because it understands the potential risk to mortgage reinsurers.

- Most courts have concluded that RESPA's one-year statute of limitations is subject to equitable tolling
- But plaintiff must plead, with specificity, "fraudulent concealment" by defendant that prevented plaintiff from discovering the existence of a claim despite due diligence. Often plaintiffs cannot meet this high pleading threshold
- To avoid RESPA's one-year statute of limitations and lack of a private right of action for certain claims, plaintiffs bring cases under state consumer protection laws
- Such laws generally have longer statutes of limitations and also provide for treble damages and attorneys' fees

- While some of the government and private actions currently facing the mortgage industry are new and unprecedented, what has not changed is the fact of litigation
- Through both good and bad economic times, there has always been plenty of litigation in this industry
- Given the current climate, and the natural tendency for finger pointing, we can anticipate more to come