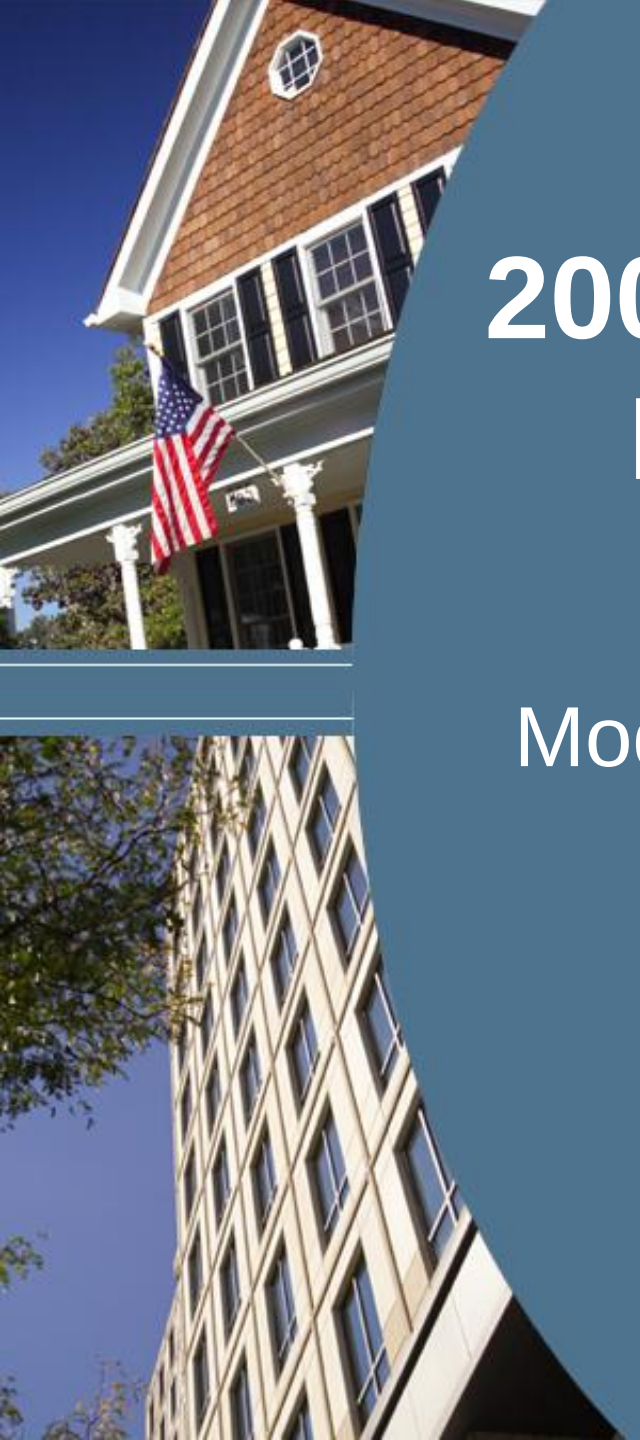

2008 MBA Conference Litigation Trends

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TILA, the old standby is back. Why?

- Complaints about nontraditional products focus on disclosure
- TILA compliance more complex for these products
- Rescission only available through TILA
- New players in consumer class actions start with “the basics”

Option ARM Cases

- Over 30 pending class actions – primarily in California federal courts
- TILA claim – alleged failure properly to disclose:
  - Negative amortization was a certainty
  - Rate was “teaser” and “would” adjust up
  - Payment cap would trigger reset
  - Details of what would be paid under various scenarios
- Tagalong state law claims – contract, unconscionability, UDAP, restitution

Option ARM Cases, so far

- Early decisions mixed
  - Countrywide, Homecomings cases dismissed with leave
  - Preemption losses for Downey, Wachovia
- Results likely to differ because non-standard notes, disclosures used
- Without TILA, certification difficult

Key Issue: Rescission

- Remedy can be devastating for lenders/servicers
  - Return of all “finance charges”
  - For loans made years earlier, total owing often exceeds $25,000
  - In class scenario, exposure can be measured in billions of dollars
- Technical violations can trigger right (but see discussion below)
- Presents two questions being debated:
  - Can borrowers bring a TILA rescission class at all?
  - Can borrowers rescind a paid off loan?

Rescission Class Actions

- Caselaw somewhat split, but weight is **against** TILA rescission classes
  - *E.g.*, McKenna v. First Horizon, 475 F.3d 418 (1st Cir. 2007)(not allowed); James v. Home Constr., 621 F.2d 727 (5th Cir. 1980)(same); LaLiberte v. Pacific Mercantile, 53 Cal. Rptr. 745 (Cal. App. 2007)(same); In re Ameriquest, 2007 WL 1202544 (N.D. Ill. Apr. 23, 2007)(allowed); Williams v. Empire Funding, 183 F.R.D. 428 (E.D. Pa. 1998)(same)
- Issue now pending before Seventh Circuit, from Andrews v. Chevy Chase, 240 F.R.D. 612 (E.D. Wis. 2007)

Rescinding Paid Off Loans

- Caselaw split, but weight is **supportive** of TILA rescission of paid loans
  - *E.g.*, Handy v. Anchor Mortgage, 464 F.3d 760 (7th Cir. 2006)(allows); Barrett v. J.P Morgan Chase, 2006 WL 997231 (6th Cir. Apr. 18, 2006)(same); King v. California, 784 F.2d 910 (9th Cir. 1986)(disallows); Shepard v. Finance Associates, 316 N.E.2d 597 (Mass. 1974)(same)
- What about foreclosed property? Short sales? Worked out loans?

TILA Grab Bag . . .

- Tension developing in caselaw on whether to excuse technical noncompliance – at least sometimes
  - *See* Santos-Rodriguez v. Doral, 485 F.3d 12 (1st Cir. 2007)(contrasting different circuit court approaches to "technical" TILA violations)
- Assignee liability
  - In re Washington, 2007 WL 846658 (Bankr. E.D. Pa. 2007("disclosure documents" the assignee is held responsible for include the note and mortgage)

"Firm offers of credit"

- The familiar story – 200+ class actions brought by small number of class lawyers based on a two **theories**
  - Initial mailer must demonstrate offer has "value." Cole v. U.S. Capital, 389 F.3d 769 (7th Cir. 2004)
  - Initial mailer must show all material terms of the offer (or of an offer, under the common law) in its "four corners." Murray v. GMAC Mortgage, 434 F.3d 948 (7th Cir. 2006)
- Most offers involve subprime, auto lending

Industry Turns The Tide

- District courts starting rejecting theories in late 2006 and into 2007, decisions became an avalanche by year's end
- First Circuit concurred
  - Sullivan v. Greenwood Credit, 2008 WL 726135 (1st Cir. March 19, 2008); Dixon v. Shamrock Financial, 2008 WL 902200 (1st Cir. April 3, 2008)
- Seventh Circuit clarified there is no "value" test and no "four corners" requirement
  - Murray v. New Cingular Wireless, 2008 WL 1701839 (7th Cir. April 16, 2008)

The Ultimate Answer?

- FCRA class actions always allege "willful" violation (15 U.S.C. § 1681n)
- Supreme Court held willfulness judged on objective standard – is the risk of violation "known or so obvious it should be known." Safeco v. Burr, 127 S.Ct. 2201 (2007)
  - Judgment for insurers where their interpretation, while wrong, had "foundation" in FCRA and subsequent caselaw supported it

What's Next?

- Furnisher liability
  - E.g., Duty to not provide information it "has reasonable cause to believe" is inaccurate
  - Exemption from civil FCRA liability, but state UDAP claims can be based on alleged FCRA violation
- Reinvestigation cases
- And, keep an eye on the credit card truncation class actions

Big Uptick in Activity

- HMDA and subprime meltdown combine

Five main areas of interest

- NAACP
- City of Baltimore
- Private class actions
- NCRC Underwriting Cases
- Enforcement actions

NAACP

- Class action seeks declaration and injunction against 18 subprime lenders
- Challenges several, defined practices
  - Marketing of loans without consumer education
  - Providing ‘steering’ incentives to brokers
  - Marketing of “teaser rate” ARMs
  - Underwriting without using fully-indexed rate
  - Making subprime loans to prime borrowers
- Claims include contention lenders should have denied credit entirely, to certain people

City of Baltimore

NCRC Cases

- Claims based on underwriting collateral restrictions (row houses, small-value properties, group homes, reservation land)
- Restrictions allegedly driven by Wall Street unwillingness to securitize loans with these types of collateral
- Some complaints have settled, two are in litigation, others pending before HUD

Private Class Actions

- Over 30 class actions against variety of lenders, pending mostly in CA, IL, MA (with same plaintiffs' counsel)
- Primarily disparate "impact" claims under ECOA and Fair Housing Act – patterned after indirect auto lending class actions
- Main theory – policy of permitting discretionary pricing has unfair impact on minority borrowers
  - Some cases focus on yield spread premiums
- Plaintiffs cite general HMDA data, advocates' "studies"

Private Class Actions (cont.)

- Defense responses
  - Claims too vague (Twombly v. Bell Atlantic)
    - policy not defined or too broad
    - no causation shown
    - Improper reliance on general industry data
    - HMDA data is incomplete
  - No “impact” claim under FHA or ECOA
- Decisions just coming down
  - Initial losses in Countrywide, Chicago cases
  - Few bright spots – Tribett v. BNC Mortgage, 2008 WL 162755 (N.D. Ill. Jan. 17, 2008)

Enforcement Actions

- Substantial activity at DOJ and banking agencies, HUD – based on HMDA data, complaints and referrals
- Recent settlements of note
  - Centier Bank (redlining)
  - Compass Bank (ECOA)
  - Springfield Ford / Pacifico Ford (discretionary pricing)
    - Dealerships permitted to mark-up financing rates
    - Reasons must be documented, related to competition, approved by supervisor

RESPA

- There has been a recent flurry of activity in the Eleventh Circuit which, as you may recall, took many years, and several decisions to finally conclude that YSP claims were not subject to class treatment
- Its recent decisions have not provided much clarity

Recent 11th Circuit Decisions

- *Krupa v. Landsafe, Inc.*, 11th Cir. affirms that average cost pricing does not violate RESPA, but on specific factual findings
- *Friedman v. Market Street Mortgage Corp.*, 11th Cir. rejects HUD's overcharge interpretation of § 8(b) where plaintiffs concede that some services were provided
- *Busby v. JRHBW Realty, Inc. d/b/a Realty South*, 11th Cir. reverses denial of class certification where plaintiffs allege no services were provided

- Other Circuit Court RESPA Decision
  - *Cohen v. JP Morgan Chase & Co.*, 2nd Cir. Adopts HUD's overcharge interpretation and finds that a single service provider may violate RESPA in case alleging no services provided

YSB Litigation

- Following the 11th Cir. 2007 decision in *Culpepper v. Irwin Mortgage Corp*., which affirmed denial of class certification and granted summary judgment for the lender, there have been few class action YSP challenges
- There have been individual claims, and plaintiffs can seek recovery of attorney's fees under RESPA
- These types of claims may become more prevalent as borrowers seek ways to get out of their current loans

YSP Claims in Disguise

- RESPA's one-year statute of limitations and lack of a private right of action has led to "creative litigation" under state consumer protection laws
- Recent challenges to the disclosure of the YSP:
  - Is a range permissible? HUD suggests "yes"
  - Was the disclosure of a range made in good faith?
  - Was the disclosure sufficient to comply with state law?

Affiliated Business Disclosures

- Homebuilder “Required Use” Cases
  - Series of recent suits filed by one firm
  - Three district courts have ruled in favor of homebuilders, but plaintiffs have appealed
  - One homebuilder settled with North Carolina regulators
  - HUD’s proposed RESPA rule would prohibit builders from offering incentives for the use of affiliates

Affiliated Business Disclosures

- Captive Title Reinsurance
  - lender's use of specific title company with reinsurance arrangement
  - Recent HUD settlements based on assertion that "little or no risk" transferred for payment
- Private Mortgage Insurance
  - Reinsurance provided by lender's affiliate
  - Several lawsuits pending on this issue

Affiliated Business Disclosures

- Sham Affiliated Business Arrangements
  - HUD, States, and plaintiffs' bar scrutinize the use of affiliates
  - Frequently problems where affiliate has no employees, all decisions made by parent, or affiliate only deals with parent
  - Key will always be whether services were provided

RESPA Reform

- The subject of a separate session, but my brief thoughts….
  - Will it happen?
  - What will it be?
  - What will the fallout/repercussions be?

Federal and State Legal and Regulatory Actions

- Federal and State governments are aggressively responding to the subprime meltdown
- Municipality Lawsuits
  - Cleveland public nuisance lawsuit against 21 investment banks
  - Baltimore reverse redlining action
  - Other municipal actions taken in response to increasing number of foreclosures

Federal and State Actions

- State Regulator Actions
  - Investigations into lending issues, including affiliated business arrangements, servicing issues, foreclosure issues, and fraud
- Attorney General Actions
  - AG Cuomo investigation into appraisal process and settlement with Fannie/Freddie
  - Cuomo investigation of investment firms
  - AG Dann of Ohio served subpoenas on servicers, promising “hundreds” more to follow

Everyone is Jumping In

- SEC Investigations
- DOJ and FBI
- US Trustee
  - Federal Bankruptcy Judge in PA authorized Office of US Trustee to investigate a lender's servicing practices
- Pilot Project to Improve Supervision of Subprime Mortgage Lenders
  - Federal Reserve, Office of Thrift Supervision, Federal Trade Commission, and two associations of state regulators join forces to conduct compliance reviews of non-depository lenders

Servicing Class Actions

- Predatory Servicing
- Bankruptcy Litigation
- MERS Litigation
- Force-placed Insurance

Predatory Servicing Cases -- A catch all of bad acts.

- Imposing unwarranted and improper fees
- Failing to credit payments received in a timely fashion
- Misapplying payments
- Prematurely referring the account to foreclosure and collections
- Failing to timely respond and communicate

Next Wave of Predatory Servicing Cases The New Complaints Allege:

1. Borrowers are deprived of proper principal reduction by:
   (a) placing customer's payments in suspense accounts
   (b) applying the customer's payments to unauthorized accounts the servicer creates
   (c) applying customer payments to unwarranted delinquency fees or arrearages.

2. Account statements contain false and misleading representations as to payment application and delinquency-related payments

3. Insurance is being force placed at unconscionably high rates

The Latest Twist –Discrimination Claims Meet Predatory Lending

- In the newest case, a lender is alleged to have entered the subprime market because subprime borrowers are predominately African Americans and Hispanics.
- As a group, these borrowers are alleged to be less able to resist predatory servicing practices than Caucasian borrowers and hence, servicing their mortgage results in greater "predatory servicing profit."
- The case is brought under the Fair Housing Act ("FHA") and the Civil Rights laws and seeks damages for, and a permanent injunction of, discriminatory lending practices.

Claims of Predatory Servicing Have Surfaced Everywhere

- Testimony before Congress
- Websites by class action counsel
- Consumer “gripe” websites
- See<http://www.ripoffreport.com/reports/ripoff65970.htm>, <http://uspeakout.com/>,<http://www.mtgprofessor.com
- State and federal regulatory agencies and prosecutors

Downsides of Predatory Servicing Litigation:

- Expensive to defend
- Negative publicity

Storm Clouds Over the Bankruptcy Courts

- 2007 and early 2008 brought an outbreak of bankruptcy class actions.

- The common theme:
  (1) in Chapter 13s mortgage servicers have not properly applied debtor payments
  (2) attorneys' fees and other servicing fees should have been, but were not, approved by the Court.

Bankruptcy Class Actions

- *In Re Reyna*, Case No. 030-75043; *Reyna v. GMAC Mortgage, LLC, et al.*, Adv. Proceeding No. 07-07007, U.S. Bankruptcy Court, S.D. TX.
- *Hernandez v. Americas Servicing Company*, Case No. CV06 07686, U.S.D.C., Central District of California.
- *In Re Andrea Mounce*, Case No. 3-55922; *Mounce v. Wells Fargo Home Mortgage*, Adv. Proceeding No. 04-05182, U.S. Bankruptcy Court, S.D. TX.
- *In re Harris*, Case No. 03-44280, *Harris v. Fidelity National Information Services, Inc.*, Adv. Proceeding No. 08-3014, U.S. Bankruptcy Court, S.D. TX.

United States Trustee Investigations: U.S. Trustees are seeking and obtaining discovery concerning companies practices relating to debtors in bankruptcy proceedings.

- *In Re Countrywide*, Misc No. 07-00204, U.S. Bankruptcy Court, W.D. PA
  50-page memorandum decision issued affirming the U.S. Trustee's right to obtain loan servicing and proof of claim documents for 293 debtors and ability to exam Countrywide representative concerning its bankruptcy servicing practices.

- *In Re Reyna*, Case No. 03-70543, United States Bankruptcy Court, S.D. TX
  Despite GMAC's settlement of the Reynas' individual claims and dismissal of the class, the U.S. Trustee was granted leave to appear *pro hac vice* to advocate for the Trustee's power to conduct an investigation.

What is a Mortgage Servicer to Do?

- Review procedures with your bankruptcy managers and bankruptcy counsel in hot spots such as Texas and California.
- Instruct Bankruptcy counsel to disclose attorneys' fees in motions seeking relief from the automatic stay.
- Have the fees and costs approved in the order for relief from stay.
- Make sure the fees and costs are part of any stipulated order for resolution.
- In Chapter 13s, amend your arrearage claim to add post-petition attorneys' fees or other servicing fees, provided you are permitted to do so in the applicable jurisdiction.

MERS Litigation

- Homeowners have begun to challenge MERS standing to foreclose in its own name, arguing that MERS is not the owner of the beneficial interest in the note or mortgage.

- A slim majority of the cases decided to date have found MERS has standing to foreclose in its capacity as nominee.

Force Placed Insurance

Class actions challenging force placed insurance continue to be Filed.

Emerging Theory: Lenders and their force placed insurance carriers are overcharging borrowers because they are allegedly overlooking extended coverage provisions in the Lenders Loss Payable Endorsement ("LLPE").

For example, in *Wahl v. American Security Insurance Co.*, Case No. 08 00555, U.S.D.C. No. D. Cal., the plaintiff argues that the lender's protection extends long past the termination of the homeowner's coverage, and until the homeowner's insurance carrier makes a specifically worded demand upon the lender.

Fremont Investment and Loan ("Fremont"): the "Poster Child" of the Subprime Lending Debacle

- Fremont was once the fourth largest originator of subprime mortgages.
- The beginning of the end: In March 2007, the FDIC and Fremont, together with its parent and affiliated companies, entered into a Consent Agreement for the issuance of a Cease and Desist Order ("Order") effectively shutting down Fremont's mortgage origination business.
- Fremont was further ordered to come up with a plan to revamp its board of directors and management as needed and restore its capital requirements.

Fremont Was Ordered To Stop:

- operating the Bank without effective risk management policies and procedures in place in relation to the Bank's primary line of business of brokered subprime mortgage lending";
- "operating with inadequate underwriting criteria and excessive risk in relation to the kind and quality of assets held by the Bank";
- "operating with a large volume of poor quality loans";
- "engaging in unsatisfactory lending practices";
- "marketing and extending adjustable-rate mortgage ("ARM") products to subprime borrowers in an unsafe and unsound manner that greatly increases the risk that borrowers will default on the loans or otherwise cause losses to the Bank…"

The Attorney General's Action

- In October 2007, the Massachusetts Attorney General filed a complaint alleging that Fremont had engaged in unfair and deceptive acts or practices in violation of Massachusetts law.

- In February 2007, the Attorney General successfully moved for a preliminary injunction barring Fremont, during the pendency of the case, from initiating or advancing any residential loan foreclosures in Massachusetts without the written permission of the Attorney General's Office.

- The Attorney General's application was supported by an affidavit of a former Fremont account executive stating that, "If a borrower had a pulse, he or she could qualify for one of Fremont's products."

The End

At the end of March 2008, the FDIC issued a supervisory prompt corrective action directive to Fremont General (the parent company) and its subsidiary, Fremont General Credit Corp. requiring them to recapitalize their bank, Fremont, by May 26, 2008.

Under the directive, Fremont was required to sell enough voting shares or obligations so that it will be “adequately capitalized” or accept acquisition offers.

On April 14, 2008, the Wall Street Journal reported that Fremont had agreed to sell its assets and deposit liabilities to Capital Source, Inc.

Hence, Fremont, which once was one of the largest lenders in the subprime market place, may soon be gone.