

BACE LAW REPORT

LEGAL NEWSLETTER

VOLUME 3, NO. 6 - JUNE 2009

Case Review: The Mortgage Crisis and Chapter 93A

In response to the Commonwealth's worsening mortgage foreclosure situation and economic crisis, the SJC recently issued an unprecedented decision directly addressing the fairness and enforceability of once popular "no money down" subprime mortgages. The case, *Commonwealth v. Fremont Investment & Loan*, 452 Mass. 733 (2008), enjoins banks from foreclosing on certain loans that the Court decided are *unfair on their face*, regardless of any deceptive activity on the part of the bank.

Mortgages are essentially written contracts, negotiated between a bank ("the mortgagee") and the borrower ("the mortgagor"), which gives the bank a secured interest in the property in return for providing the funds necessary for the purchase.

Traditionally, banks required borrowers to produce as much as twenty-percent of the purchase price in cash as a down payment, in addition to proving their credit-worthiness. In the event of a default, the secured bank generally has rights to foreclose on the property, remove the owners, and force the sale of the property in order to recoup their investment. Determining the genesis of the global economic downturn requires complex analysis beyond the scope of any brief newsletter. However, any discussion of the current state of the economy invariably must include the mortgage crisis. The advent of "no money down," government-backed Federal Housing Administration mortgages, coupled with the downturn in the economy have created an explosion in the number of foreclosures in the Commonwealth.

The following chart based on data from

The Warren Group, illustrates the increase in Foreclosure Petitions in the Commonwealth, by County, from 2005 to 2006:

County	2005	2006	Pct Change
Barnstable	470	910	93.62%
Essex	1318	2307	75.04%
Hampden	1169	1803	54.23%
Middlesex	1707	2839	66.32%
Norfolk	922	1389	50.65%
Plymouth	1306	2223	70.21%
Suffolk	112	2015	78.79%
All of Mass.	11155	18926	69.66%

Foreclosure Petitions, and the Sheriff's sale that follows can leave the property abandoned for months. These foreclosed homes are subject to vandalism and deterioration, thereby reducing already falling property values in the hardest hit neighborhoods.

In response, the Attorney General's office filed suit in Superior Court for a preliminary injunction (court order) aimed at slowing a particular bank from foreclosing on certain mortgages. The Commonwealth's

consumer protection act, Chapter 93A, provides a cause of action when a consumer has been the victim of the "unfair or deceptive" acts of a business engaged in trade or commerce; The act also empowers the AG's Office to file suit on behalf of consumers as an enforcement mechanism. The AG's Office did not claim that the bank was participating in deceptive actions, but that the very terms of their adjustable rate mortgages were patently unfair, and thus, *per se* violations of Chapter 93A, requiring court approval prior to foreclosure.

Judge Gants, with whom the principle of this office had the pleasure of studying Civil Motions as a law student, declared that, "it is unfair for a lender to issue a home mortgage loan...that the lender reasonably expects will fall into default...unless the fair market value of the home has increased at the close of the introductory period." *Id.* at 740. It is important to note that the Court found no evidence that the bank was engaged in any deceptive activity; In

fact, there were no misrepresentations of the terms of the loans, and no concealment as to what the borrowers to expect to pay after the introductory period. Regardless of whether or not a bank is participating in unfair or deceptive acts, it appears that mortgages with the following characteristics will require oversight from the Attorney General's office, and court approval, prior to foreclosure:

1. The borrower was offered a low introductory interest rate for the first three years;
2. The rate increased to a much higher rate after that introductory period;
3. When the higher rate was in effect, the borrower would need to pay greater than 50% of her income in order to meet the new payments; and,
4. The amount borrowed was 100% of the value of the house at the time of closing, or the loan documents imposed a substantial penalty for prepayment.

Even if all four of these characteristics are present, the implications of the Court's decision are not staggering; it appears the bank in question will require the involvement of the Attorney General's office, prior to foreclosing

on those mortgages. However, the case may serve as a valuable precedent for consumers who have been "damaged" as a direct result of similar mortgage. Fremont deals exclusively with the Attorney General's interests in enforcing and overseeing foreclosure of similar mortgages, and the Court was careful to note that the injunction "in no way relieved borrowers from...their obligation to repay the loans they had received." *Id.* at 741. However, Fremont may give rise to other plaintiffs arguing that their mortgages are similarly unfair, and that they should be duly compensated for their loss. Loss assumes damages, which is the hurdle such a plaintiff would be required to prove in order to recover from the bank. The Supreme Judicial Court affirmed Judge Gants, who was later appointed to the SJC in January of 2009.

ADVERTISING: This newsletter is a form of advertising, and does NOT create an attorney-client relationship of any kind. The information in this newsletter should NOT be relied upon, and should NOT be considered legal advice. Legal advice can only be issued after a careful review of the facts of your particular matter.