Schnader
ATTORNEYS AT LAW

Schnader Harrison Segal & Lewis LLP

NEW YORK PENNSYLVANIA CALIFORNIA WASHINGTON, D.C. NEW JERSEY DELAWARE

FINANCIAL SERVICES LITIGATION
ALERT

May
2012

Resolving the Split on Split Fees Under RESPA: *Freeman v. Quicken Loans* Holds That Fee-Splitting Is Prohibited Only if the Fee Actually Is Split

By Stephen A. Fogdall and Elizabeth Nicolas

On May 24, 2012, the Supreme Court of the United States issued a unanimous decision in *Freeman v. Quicken Loans, Inc.*, No. 10-1042, 566 U.S. __ (2012), resolving a split between the Second and Fifth Circuits as to whether Section 8(b) of the Real Estate Settlement Procedures Act ("RESPA") prohibits a settlement-service provider from charging a borrower an "unearned" fee, *i.e.*, a fee for which the settlement-service provider in fact provides no service to the borrower. The court held that such unearned fees are not prohibited by the statute; rather, Section 8(b) is violated only where a provider splits a portion of a settlement-service fee with one or more third parties.

Section 8(b) of RESPA states that "[n]o person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service … other than for services actually performed." RESPA § 8(b), codified at 12 U.S.C. § 2607(b). The plaintiffs in *Freeman* alleged that Quicken Loans ("Quicken") had violated this provision by charging them various "loan discount," "loan processing" or "loan origination" fees without providing any services in return for the fees. According to the plaintiffs, by charging these unearned fees, Quicken had "accepted" a "portion" or "percentage" (specifically, the entire "portion" or "percentage") of a "charge" made to the plaintiffs "other than for services actually performed," thus violating Section 8(b), even though no "portion, split, or percentage" of the charge ever was shared with a third party.

The interpretation urged by the *Freeman* plaintiffs was not without support. A policy statement issued by the Department of Housing and Urban Development ("HUD") in 2001 interpreted Section 8(b) to prohibit a settlement-service provider from charging such an unearned (but unshared) fee. Moreover, the Second Circuit had considered this interpretation in *Cohen v. JP Morgan Chase & Co.*, 498 F.3d 111 (2d Cir. 2007), and concluded that the phrase "any portion, split, or percentage" in Section 8(b) was ambiguous and could "plausibly be construed" to prohibit "all unearned fees, however structured." *Id.* at 120. Thus, the Second Circuit deferred to HUD's policy statement under the *Chevron* doctrine. *Id.* at 126. (In 2011, after *Cohen* was decided, HUD's authority to interpret and enforce RESPA was transferred to the Consumer Financial Protection Bureau ("CFPB"), pursuant to the Dodd-Frank Act. The CFPB has adopted the HUD policy statement.)

The district court in *Freeman* rejected the Second Circuit's analysis and granted summary judgment to *Quicken*. The Fifth Circuit affirmed, concluding that Section 8(b) "is unambiguous and does not cover undivided unearned fees." *Freeman v. Quicken Loans, Inc.*, 626 F.3d 799, 803 (5th Cir. 2010). The Supreme Court granted certiorari to resolve the circuit split and affirmed the Fifth Circuit's ruling.

The Supreme Court reasoned that Section 8(b), by its plain terms, contemplates two separate exchanges: a borrower-provider transaction in which a "charge" is "made" by a settlement-service provider to a borrower and "received" from that borrower, and then a separate fee-sharing transaction, in which the charge "made" to, and "received" from, the borrower is "give[n]" to, and "accept[ed]" by, another party. Slip Op. at 6.

According to the *Freeman* plaintiffs' own allegations, the second, fee-sharing transaction required by the statute never occurred. Rather, Quicken's alleged violation was that it "made" charges to the plaintiffs, without providing any service in return, and simply pocketed the fees for itself. For such an unearned, but undivided, fee to be actionable, Section 8(b) would have to be read to prohibit a settlement-service provider from "accepting" from a borrower an unearned fee that it had itself "made" to that borrower. The Supreme Court rejected such a reading for two reasons. First, that interpretation would require the phrase "any portion, split or percentage" in Section 8(b) to include the en-

(continued on page 2)

(continued from page 1)

tirety of the allegedly unearned fees Quicken received from the plaintiffs, since, on the plaintiffs' theory, no portion or percentage of these fees was ever shared with another party. According to the Supreme Court, such an interpretation is implausible, because "portion, split, or percentage" most naturally refers to "a part of a whole," not the entirety. Slip Op. at 10. Second, on the plaintiffs' interpretation, if Quicken violated Section 8(b) by "accepting" these allegedly unearned fees, then the plaintiffs likewise violated the statute by "giving" them to Quicken, which would subject to liability under RESPA the very "class RESPA was designed to protect," a consequence the Court rejected as "virtually unthinkable." *Id.* at 8. Thus, the Court concluded, to establish a violation of Section 8(b), "a plaintiff must demonstrate that a charge for settlement services was divided between two or more persons." *Id.* at 13. Moreover, because the statute was unambiguous, HUD's contrary interpretation was entitled to no deference. *Id.* at 6.

While *Freeman* resolves the circuit split as to whether Section 8(b) prohibits undivided unearned fees, there is a related circuit split that *Freeman* does not explicitly address. The Second, Third and Eleventh Circuits have held that Section 8(b) prohibits a settlement-service provider from "marking up" a third party's charge for a settlement service if it provides no additional services to the borrower to justify the markup. See *Kruse v. Wells Fargo Home Mortgage, Inc.*, 383 F.3d 49 (2d Cir. 2004); *Santiago v. GMAC Mortgage Group, Inc.*, 417 F.3d 384 (3d Cir. 2005); *Sosa v. Chase Manhattan Mortgage Corp.*, 348 F.3d 979 (11th Cir. 2003). The Fourth, Seventh and Eighth Circuits have held that such markups are not prohibited. *See Boulware v. Crossland Mortgage Corp.*, 291 F.3d 261 (4th Cir. 2002); *Krzalic v. Republic Title Co.*, 314 F.3d 875 (7th Cir. 2002); *Haug v. Bank of America, N.A.*, 317 F.3d 832 (8th Cir. 2003).

The Supreme Court's reasoning in *Freeman* likely favors the latter approach. To take a simple illustration, suppose that a settlement-service provider hires a third-party vendor to perform a settlement service for a borrower for a price of $100. The settlement-service provider then charges the borrower $200 for that service without adding any additional services of its own to justify the markup. Arguably, the settlement-service provider splits the $200 charge paid by the borrower with the third-party vendor, because $100 of that $200 charge goes to pay the vendor's fee. *See, e.g., Santiago*, 417 F.3d at 389 (reasoning that marking up a third party's charge is equivalent to sharing a portion of the increased charge with that third party). Nevertheless, *Freeman*'s analysis indicates that the markup from $100 to $200 is not actionable under Section 8(b). In the illustration, the $100 paid to the third-party vendor is "for services actually performed." Thus, there can be no claim under Section 8(b) based on that portion of the $200 charge. Hence, any claim under Section 8(b) would have to be based not on the $100 shared with the third-party vendor, but on the additional unearned $100 portion charged by the settlement-service provider to the borrower. As described, that portion is not shared with any other party, but is kept by the settlement-service provider for itself, and is only alleged to be actionable because no additional services were provided to justify the markup. But *Freeman* holds that charging such an unearned fee does not violate Section 8(b). As such, there presumably can be no claim under Section 8(b) based on the unearned $100 markup, either. Put differently, no component of the $200 charge is both shared with another party and "other than for services actually performed." The markup claim recognized in *Kruse*, *Santiago* and *Sosa* may therefore not survive *Freeman*. ◆

For more information about Schnader's Financial Services Litigation Practice Group or to speak with a member of the Firm at a particular Schnader office location, please contact:

Stephen J. Shapiro, Co-Chair
215-751-2259
sshapiro@schnader.com

Christopher H. Hart, Co-Chair
415-364-6707
chart@schnader.com

Stephen A. Fogdall
202-419-4208
sfogdall@schnader.com

Elizabeth Nicolas
215-751-2574
enicolas@schnader.com

www.schnader.com