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Legal Updates & News

Bulletins

Financial Services Report, Fall 2007

September 2007

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Editor's Note

On The Edge

The kids are back in school, and the air has the user-interface of autumn. We thought we should revisit the smoldering questions that were on people's lips this summer. Here's our Top Five list:

> If my phone number appears in the Washington Madam's rolodex, is that a sign it's finally time to get caller blocking? Orange croc shoes with that Hawaiian top, or green? Has the LA County jail upstaged the Montmartre Lounge for celebrity spotting, and will the sheriff add velvet ropes? Will Sunday-night canasta replace The Sopranos? How many gallons per flush does NASA's $19 million Russian-built space toilet really use? These may not be quite up to Poincaré's conjecture, but thanks for asking.

We were a little thin this quarter on stories about alien love children, so we're going with column fillers. In Washington, the Supremes decided *Safeco/Geico*, and their analysis of what "willful" means could short-circuit FCRA class actions. Credit card truncation class actions took wing and are migrating, while their first cousins, the "firm offer of credit" cases, continue to leave their calling cards. Finally, the Second Circuit did an about-face on RESPA Section 8 and fee-splitting. All this plus more, inside.

Until next time, this disclaimer: This column may have been printed with ink made in China and may be subject to recall.

William L. Stern, Editor

MoFo Metrics

20	Percentage of Americans who vacation with their laptop
5	Tons of methane gas produced per cow per year
3.4	Tons of CO2 produced per average U.S. commuter per year
68	Dollars in carbon offsets represented by that CO2 production
66	World record for number of hot dogs consumed in 12 minutes
17	Number of calories (000's) world hot dog eating champion ingests
8.5	Average daily calories (000's) consumed by Tour de France cyclists
246	Confirmed planets orbiting suns other than our own

Beltway Report

Unfair Or Deceptive Acts Or Practices
In August, the Office of Thrift Supervision ("OTS") issued an Advance Notice of Proposed Rulemaking seeking public comment on approaches for expanding its regulation of unfair or deceptive acts or practices. The OTS is trying to figure out whether further rulemaking on unfair and deceptive trade practices should cover products and services in addition to consumer credit and whether any such rules should extend beyond financial products and services. More fundamentally, the OTS is evaluating whether to use a principles-based model or a specific-prohibition model in regulating such practices. The Proposed Rule targets several hot-button topics, including: for credit cards—universal default, imposition of over-limit fees triggered by penalty fees, and penalty fees charged for consecutive months based on previous offenses; for mortgages—repetitive refinancing of the same mortgage by the same lender; and for gift cards—imposing fees exceeding a certain amount or a percentage of gift amount and setting an expiration date less than one year from issuance.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

Protection For Seals
In July 2007, the House Committee on Financial Services passed H.R. 2547, the FDIC Enforcement Enhancement Act, imposing penalties on companies falsely claiming to be FDIC-insured. "Public confidence in the FDIC seal is every bit as important as the FDIC guarantee itself – if we don't protect the seal, we'll lose the power of the guarantee," said Congresswoman Judy Biggert. The fine for violators: Up to $1 million per day. That will make your latte bitter.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

Investment Advisers Beware
The SEC has a new anti-fraud wrench in its tool kit. Earlier this year, the SEC proposed Rule 206(4)-8 under the Investment Advisers Act of 1940 in response to a ruling by the Court of Appeals for the D.C. Circuit Court in *Goldstein v. SEC*, 451 F.3d 873 (D.C. Cir. 2006). The SEC was concerned that the court's *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.

For more information, contact Will Stern at wstern@mofo.com.

More Red Flags
The interagency regulation implementing the "Red Flag" guidelines under the FACT Act still appears to be a work in progress. But, in the meantime, the federal banking agencies continue to address issues relating to data security and identity theft. In April, the FDIC issued its "Supervisory Policy on Identity Theft," which describes the characteristics of identity theft. The FDIC policy also sets forth the agency's expectations that banks under its supervision will take steps to detect and prevent identity theft and mitigate its effects in order to protect consumers and help ensure safe and sound operations of FDIC-regulated financial institutions.

In particular, the FDIC guidance indicates that banks under the supervision of the FDIC should, among other measures, properly safeguard and dispose of consumer information; use stronger and more reliable methods to authenticate the identity of customers using electronic banking systems; and provide consumers with accurate, up-to-date information designed to educate them concerning steps to take to reduce their vulnerability to fraud.

For more information, contact Rick Fischer at rfischer@mofo.com.

Minnesota Ramps Up Breach Notification
Minnesota's newly-amended breach notification law, H.F. 1758, went into effect August 1. The security requirements apply to any "person or entity conducting business in Minnesota" that accepts credit cards, debit cards, stored value cards, or similar cards "issued by a financial institution." Such companies are prohibited from storing for more than 48 hours (i) magnetic stripe data, (ii) the three- or four-digit security code (a/k/a "CVV2"), and (iii) any PIN verification number. The liability provisions kick in a year from now, and will require companies to reimburse the card-issuer for the "costs of reasonable actions" both to protect its cardholders' information and to continue to provide services to its cardholders after a breach.

For more information, contact Tom Scanlon at tscanlon@mofo.com.

Privacy Report

Seventh Circuit Says No "Fear Of Id Theft"
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,* No. 06-3817, 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.

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For more information, contact Tom Scanlon at tscanlon@mofo.com.

Ahead of the Summons

New Directions For The "Truncation" Bar

FACTA "truncation" suits are the new "Tickle Me Elmo" to the plaintiffs' class action bar. Since FACTA took effect in December 2006, over 200 such lawsuits have been filed. These charge that a retailer (or restaurant) has failed to truncate credit card numbers and/or expiration dates on the customer's receipt; most involve printed expiration dates. A "willful" violation can draw statutory penalties of up to $1,000 per violation, which can add up fast. This last quarter, these cases have spun off into several sub-orbits.

First, remember *Rodash*? Two federal judges have joined the queue of courts that refuse to certify these as class actions. In one, the court noted that the defendant had quickly fixed the problem; thus, a class action was not "superior" because any damage award would be hugely disproportionate to any actual damage. *Soualian v. Int'l Coffee & Tea LLC*, 07-CV-502-RGK, 2007 U.S. Dist. LEXIS 44208 (C.D. Cal. June 11, 2007). In the other, the court also focused on the lack of actual harm and the "disastrous consequences" to defendant's business and its employees if a class were certified. *Spikings v. Cost Plus, Inc.*, 06-CV-8125-JFW, 2007 U.S. Dist. LEXIS 44214 (C.D. Cal. May 25, 2007).

Second, just because you are not a retailer doesn't necessarily mean you will slip under the scythe. Retailers are suing their equipment suppliers for indemnity on the theory that the equipment vendor's failure to supply them with point-of-sale devices capable of printing FACTA-compliant receipts is a breach of implied warranty. POS suppliers who didn't do so will now wish they had disclaimed implied warranties.

Third, counsel are stretching the concept of FACTA "receipt" into the world of e-commerce. New suits have been filed on the theory that the confirmation slip you get after making an on-line order in the privacy of your own home is a "receipt" that must be truncated.

For more information, contact Dave McDowell at dmcdowell@mofo.com.

Premature Speculation

Plaintiffs' counsel are increasingly turning to consumer protection class actions instead of, or in conjunction with, personal injury class actions. These claims are usually brought under state unfair and deceptive trade practices acts. And why not? It's easier to get a UDTPA class certified. Personal injury claims, by contrast, often require proof of messy individual issues regarding liability and damages. The latest bonanza is a race between suing over a nondisclosure that, by not being disclosed, allegedly diminishes the value of the good or service, and bringing a class action to get consumers' money back, alleging that the product might fail after the warranty expires.

For more information, contact Will Stern at wstern@mofo.com.

Back, Waves!

King Canute's got nothing on Congress. Senator Russ Feingold and Congressman Hank Johnson think consumer arbitration is bad, so they introduced legislation aimed at ending mandatory arbitration in consumer contracts. The Arbitration Fairness Act of 2007 would amend the Federal Arbitration Act to make pre-dispute agreements to arbitrate employment, consumer, franchise, or civil rights disputes unenforceable. In addition, it specifies that questions as to whether the Act applies will be resolved in court, not through arbitration.

For more information, contact Rebekah Kaufman at rkaufman@mofo.com.

California Report

Miller's Crossing

Remember *Miller v. Bank of America*, the case on appeal to the California Supreme Court? There, a trial court in San Francisco held that a bank may not cover debits owing for overdrafts and overdraft fees against credits held in checking accounts that include direct-deposited Social Security and other public benefit payments. The appellate court reversed.

The OCC hasn't forgotten. It issued an interpretive letter in May, stating that OCC regulations authorize national banks to honor overdraft items and recover overdraft fees if done in accordance with the deposit agreement and applicable fee schedule. OCC Interpretive Letter No. 1082, 5/17/07. Although the OCC did not specifically comment on Miller, the letter makes it clear that the Bank applied its overdraft practices regardless of whether the funds in the depositor's account came from public benefits or some other source. The OCC's letter may help national banks with California depositors overcome any adverse ruling in Miller.

For more information, contact Michael Agoglia at magoglia@mofo.com

Escheat That!
Or rather, in the case of the California Controller, don't even think of accepting, taking title to, or taking possession of any property or selling, converting to cash or destroying any unclaimed property, including the contents of state deposit boxes. On June 1, a federal judge in Sacramento issued a preliminary injunction blocking the Controller from taking any action pursuant to the California Unclaimed Property Law ("UPL") until the Controller promulgated and the Court approved regulations providing for notice to the owner and the public. *Taylor v. Westly*, CIV S-01-2407 WBS GGH, 2007 U.S. Dist. LEXIS 43711 (E.D. Cal. June 1, 2007). The district court's ruling followed a Ninth Circuit decision granting a preliminary injunction on grounds that plaintiffs had shown they were likely to succeed in proving that providing notice by publication, mailing notice to some but not all individuals whose property would be escheated, and relying on property holders to provide notice prior to escheat violated plaintiffs' due process rights.

A few weeks later, a panel of the California Court of Appeals held in an unpublished ruling that the Due Process clause does not require the State to give notice prior to converting unclaimed stock to cash under the UPL. *Porcile v. Connell,* No. B187092, 2007 Cal. App. Unpub. LEXIS 4878, at *10-*11 (June 19, 2007). Despite this ruling, all unclaimed property in California will stay right where it is for the foreseeable future. Will federal courts in other circuits follow suit in challenges to state laws with similar notice provisions?

The State Controller announced reforms, and said that the budget bill signed on August 23 will allow for a new method of contacting property owners that complies with the law.

Failure To Attach
A California Court of Appeal issued a troubling decision for insurers in *Ticconi v. Blue Shield of California Life & Health Ins. Co.*, 2007 WL 2171556 (July 30, 2007). In that class action case, a disability insurer failed to attach the policyholder's application or make it an endorsement to the insurance policy. Plaintiff argued that this amounts to prohibited "post claims underwriting" and sought to certify a class of similarly-situated insureds. The trial court denied class certification due to the presence of individual defenses (e.g., fraud and unclean hands) unique to the named plaintiff, but the appellate court reversed. It held that unclean hands and fraud are not defenses to claims brought under California's unfair competition law and that even if these defenses applied to the remedy, they would not prevent class certification.

For more information, contact Dan Marmalefsky at dmarmalefsky@mofo.com.

Neither A Good Nor A Service Be
A decision handed down in late August by a California appellate court holds that insurance is neither a "good" nor a "service" within the meaning of the Consumer Legal Remedies Act, Cal. Civ. Code § 1750 et seq. The court stated: "This case presents a difficult issue of first impression; plausible arguments can be made on both sides of the issue. We ultimately conclude, however, that the more persuasive and better reasoned argument requires that we hold that insurance is neither a 'good' nor 'service' within the meaning of the CLRA." *Fairbanks v. Superior Court,* No. B198538.

For more information, contact Will Stern at wstern@mofo.com.

Operations Report

"Green" Transactions
A little summer beach reading? At the end of June, the FRB approved a final rule exempting transactions of $15 or less from Reg E's requirement that receipts be made available to consumers for transactions initiated at an electronic terminal. In the course of adopting the rule, the Fed rejected proposals by Visa and other industry representatives who wanted the dollar threshold increased to $25. Industry reps favored the $25 threshold for consistency with payment card association rules waiving the PIN and signature authorization requirements for certain merchants for transactions under $25. The Fed acknowledged the threshold might not accommodate

price increases and promised to monitor the market and revisit the dollar threshold as necessary.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

Basel Too
Just five months before banks are scheduled to begin a trial run of the new capital regime, regulators reached agreement on some gnarly issues that threatened to prevent the agencies from issuing final rules on the new capital regime: For the largest 10-20 banks in the U.S. ("core banks"), the regulators will seek to align the U.S. Basel II's "advanced approach" more closely with the international agreement. Sample calculations under the advanced approach by core banks had shown the prospect of reductions in required capital. This had led U.S. regulators to limit aggregate reductions in risk-based capital for core banks under the advanced approach to 10%. This limitation has now been abandoned.

Instead, the agreement limits capital reductions to 5% in the first year of implementation, 10% in the second year, and 15% in the third year. The regulators will be required to assess by the end of the second year of implementation whether there are any material deficiencies in the new framework and will have the authority to adjust the regulation to address them, if necessary. For non-"core" banks, the proposed Basel 1A approach has been abandoned. Instead, to preserve the competitiveness of smaller banks, the non-core banks will be offered the choice to continue under Basel I or to adopt the so-called "standardized approach" outlined in the international agreement. The agencies have yet to issue regulations reflecting this agreement. Look for continued controversy on this agreement.

For more information, contact Henry Fields at hfields@mofo.com.

Creditor's Rights

One More Reason To Hate Discovery
Here's a cautionary tale for attorneys involved in consumer debt collection. In *Sayyed v. Wolpoff & Abramson*, 485 F.3d 226 (4th Cir. 2007), the Fourth Circuit held that all documents filed with the court or served on debtor's counsel during a debt collection lawsuit—including discovery documents, briefs, or other filings—must comply with the Fair Debt Collection Practices Act by including the statutory debt collection warnings required by the FDCPA and by being free of any false or misleading statements. Defendant, a law firm retained to prosecute a collection action for a defaulted credit card debt, argued that an absolute common law litigation immunity exempted their discovery requests and briefs from the FDCPA, and that communications with debtor's counsel were outside the FDCPA. The Fourth Circuit rejected defendant's arguments and concluded that debt collection attorneys remain subject to the FDCPA's requirements during litigation—even when serving interrogatories.

For more information, contact Eric Olson at eolson@mofo.com.

Firm Offer Update

The Firm serves as coordinating counsel to the Mortgage Bankers Association in the so-called "firm offer of credit" class actions, so each issue we track the developing case law under the FCRA.

Supremes Issue "Willful" Guidance
By far, the most significant development is that, 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, in which Morrison & Foerster filed an amicus brief. Reversing Ninth Circuit precedent, these rulings contain four significant holdings, two of which favor plaintiffs and two of which favor defendants.

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.

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 objectively unreasonable. The Court concluded that where no clear Circuit or authoritative agency interpretation of the FCRA issue existed, and where the district court found defendant's construction correct, there was no way the conduct could have been "willful."

The upshot: Plaintiffs should not get intrusive discovery before the court decides whether defendant's interpretation of the FCRA was reasonable, even if incorrect.

For more information, contact Michael Agoglia at magoglia@mofo.com.

Offer a Minimum Amount of Credit

On August 7, a Missouri judge issued a highly favorable firm offer decision in *Poehl v. Countrywide Home Loans,* No. 4:06CV928. Granting Countrywide's motion for judgment on the pleadings, the court found 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.

For more information, contact Michael Agoglia at magoglia@mofo.com.

Failing To Actively Solicit Callers

Proving that wildly irrational decisions still continue in this area, we offer *Bernal v. American Money Centers, Inc.,* No. 05-CV-1327, 2007 U.S. Dist. LEXIS 57274 (E.D. Wis. Aug. 6, 2007) in whch the court found that pre-screened mailings were not a firm offer of credit because the mailing itself 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.

For more information, contact Michael Agoglia at magoglia@mofo.com.

Credit Card Report

Congress Getting Ready To Act

In Dante's seventh ring of hell, money lenders are consigned to a flaming desert of sand. Some in Congress probably think Dante was letting them off easy. Representative Carolyn Maloney promised to introduce legislation in September that would ban credit card practices such as mandatory arbitration, universal default, double-cycle billing and retroactive rate increases and require additional disclosures. Many card issuers have stopped doing these things already.

This follows a series of private roundtable discussions among six top issuers and representatives of consumer groups this summer, hosted by Representatives Maloney and Barney Frank. Rep. Maloney offered four principles to serve as the foundation of credit-card reform legislation. She wants to make sure that card issuers consider customers' ability to repay when issuing new cards, provide clear disclosures and adequate notice, and encourage responsible credit use.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

Cuomo's Credit Card Crusade

New York Attorney General Andrew Cuomo announced an agreement whereby First Premier agreed to pay

$4.5 million in refunds and $105,000 in penalties and costs for alleged unfair practices in soliciting high-risk credit card customers. The NY AG alleged that First Premier's credit card offered high "up to" credit limits and promised no processing fees even though consumers who accepted the offers received a much lower credit line and were billed large upfront fees. Premier Bank issued a statement explaining that it had discontinued the challenged practices on its own initiative several years ago.

Arbitration Report

Washington State Joins Conga Line
The Washington Supreme Court has joined the growing list of courts that refuse to enforce class action waivers. *Scott v. Cingular Wireless,* No. 77406-4, 2007 Wash. LEXIS 479 (July 12, 2007). The Washington Supreme Court concluded that the class action waiver included in Cingular's standard subscriber contracts is unconscionable because it effectively denies large numbers of consumers the protection of Washington's Consumer Protection Act and effectively exculpates Cingular from liability for a whole class of wrongful conduct. The court was unpersuaded by Cingular's argument that it had cured any concerns about access to a remedy by promising to pay arbitration and attorney's fees under certain circumstances.

For more information, contact Rebekah Kaufman at rkaufman@mofo.com.

Cingular Dials 9th Circuit, Gets Wrong Number
The Ninth Circuit rejected a class action waiver in New Cingular Wireless Service's standard cell phone service contract. *Shroyer v. New Cingular Wireless Services, Inc.*, No. 06-55964 (9th Cir. Aug. 17, 2007). The panel found that the class action waiver was both procedurally and substantively unconscionable under the test developed by California appellate courts construing the California Supreme Court's decision in *Discover Bank*. Like the Washington Supreme Court, the panel was not persuaded otherwise by the availability of attorney's fees and arbitration costs. The panel further held that the FAA does not preempt state contract law principles such as unconscionability.

For more information, contact Rebekah Kaufman at rkaufman@mofo.com.

Pennsylvania Ok's Limited Carve-Outs
The Pennsylvania Supreme Court upheld the validity of an arbitration clause in a mortgage loan contract that required the borrower to resolve his disputes in arbitration, but that allowed the lender to bring a foreclosure action in court. *Salley v. Option One Mortgage Corp.*, No. 50 EAP 2005, 2007 WL 1583359 (Pa. May 31, 2007). The court rejected plaintiff's contention that this limited, unequal access to court is unconscionable.

For more information, contact Rebekah Kaufman at rkaufman@mofo.com.

Preemption Report

***Smooth Sailing in the Wake of* Watters**
The first two cases to cite the Supreme Court's decision in *Watters v. First Wachovia* found that claims brought under state laws were preempted by federal banking laws and regulations. In a significant victory for the banking industry, the First Circuit found that the National Bank Act, HOLA, and OCC regulations preempt a New Hampshire law regulating the sale of gift certificates, including stored-value gift cards. *SPGGC LLC v. Ayotte*, 488 F.3d 525 (1st Cir. 2007). The court relied on the Supreme Court's analysis in Watters in concluding that preemption applied to sales of the challenged gift cards by a shopping mall owner that was selling the gift cards under a contract with U.S. Bank. MoFo's James McGuire represented U.S. Bank.

The Fourth Circuit held that the FDIA completely preempts state-law usury claims brought against a state-chartered federally insured bank such that the bank's counterclaim under the FDIA created a basis for subject matter jurisdiction by the federal court. *Discover Bank v. Vaden*, 489 F.3d 594 (4th Cir. 2007). The panel found that the district court correctly compelled arbitration of the action in accordance with the plaintiff's agreement to arbitrate.

For more information, contact James McGuire at jmcguire@mofo.com.

Seventh Circuit Drops Back, Punts
In *In re Ocwen Loan Servicing, LLC Mortgage Servicing Litigation*, 2007 WL 1791004 (7th Cir. June 22, 2007), the Seventh Circuit found that the allegations in a complaint asserting state-law claims against a mortgage servicer did not provide enough information to allow the court to evaluate whether many of the claims were preempted by HOLA and OTS regulations. In a colorful opinion, Judge Posner marched through the claims alleged under common law and state consumer protection statutes, making it clear that it is the nature of the claim rather than its label that determines whether a cause of action is preempted. The opinion draws a clear line between allegations of breach of contract and misrepresentation, which are not preempted, and allegations that would interfere with federal banking regulations.

Mortgage Report

RESPA—The Real McJob
In a departure from the holdings of three other federal circuits, the Second Circuit has ruled that undivided fees charged by a lender or other settlement services provider may be subject to Section 8(b) of RESPA. In *Cohen v. J.P. Morgan Chase & Co.*, 2007 U.S. App. LEXIS 18620 (2d Cir. Aug. 6, 2007), the court concluded that RESPA's prohibition on unearned fees was ambiguous as to whether that prohibition applied to both divided and undivided fees. Although the Fourth, Seventh, and Eighth Circuits have concluded that RESPA's unearned fee provisions only apply to fees divided with another culpable party, the Second Circuit held that HUD's broader interpretation of the statute was correct, and it vacated the trial court's dismissal of a claim predicated on a "post-closing fee" for which no services allegedly were provided.

For more information, contact Michael Agoglia at magoglia@mofo.com.

Meanwhile, in the Land of 10,000 Lakes …
Under a new law effective August 1 (H.F. 1004), mortgage brokers in the State of Minnesota are subject to the standard of a fiduciary in protecting the best interests of the borrower. Brokers may no longer provide a disclosure disclaiming such duties.

For more information, contact Eric Olson at eolson@mofo.com.

Subprime Piñata
This year, fall foliage means watching summer's subprime barbeque turn into fall's subprime piñata. Congress and state legislators are on the march. And in July, the NAACP sued a dozen lenders in federal court in Los Angeles, alleging that mortgage loans were made to African-American borrowers on terms that were statistically more unfavorable than loans to white borrowers. A number of private class action suits have followed, all brought on a similar theory, many of which target yield spread premiums.

Also in July, the FRB, OTS, FTC, and associations of state regulators announced plans for a collaborative state/federal project to examine subprime lending. The project will focus on non-depository subsidiaries of bank and thrift holding companies, as well as state-licensed subprime lenders and mortgage brokers doing business with any of those entities. Regulators hope the coordinated state/federal approach will enable regulators to evaluate and more consistently assess subprime lending practices, including underwriting, risk-management policies and procedures, and compliance with federal regulatory laws.

For more information, contact Eric Olson at eolson@mofo.com.

States Follow Feds on Subprime Guidance
No surprises here. States are beginning to adopt the Statement on Subprime Mortgage Lending issued on June 27 by a collection of federal regulatory agencies. The Conference of State Bank Supervisors, the American Association of Residential Mortgage Regulators, and the National Association of Consumer Credit Administrators jointly released a statement calling on state regulators around the country to adopt the federal guidance for state-regulated mortgage lenders. Regulators in at least 26 states have signaled their intent to do so.

For more information, contact Eric Olson at eolson@mofo.com.

Culpepper Loses Again
Apparently out to break the record held by Police Academy VII, plaintiffs in the decade-long yield spread premium class action *Culpepper v. Irwin Mortgage Corporation* have suffered another—and likely final—loss in

the Eleventh Circuit. On July 2, the Eleventh Circuit issued *Culpepper IV* (see 2007 U.S. App. LEXIS 15735 (11th Cir. July 2, 2007)), affirming summary judgment for defendant lender. The court held that plaintiffs failed to provide evidence that the compensation paid to their mortgage brokers was unreasonable in light of the services that they provided. Additionally, the court also affirmed decertification of the class, concluding that individual questions of fact predominate in "these types of RESPA actions."

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Reining In Rescission Abuse

The Fourth Circuit got this one right. *In American Mortgage Network v. Shelton*, 486 F.3d 815 (4th Cir. 2007), a Truth in Lending Act case involving the borrowers' attempt to rescind their fraudulently-obtained loan, the court followed the Ninth Circuit's holding in *Yamamoto v. Bank of New York,* 329 F.3d 1167 (9th Cir. 2003), and held that unilateral notification of cancellation under TILA by a borrower does not automatically void the loan and the lender's security interest. "Clearly," the court concluded, "it was not the intent of Congress to reduce the mortgage company to an unsecured creditor or to simply permit the debtor to indefinitely extend the loan without interest." Because the borrowers were unable to tender the proceeds of their loan, and because they had unclean hands by obtaining their loan through various false representations that the trial court characterized as so egregious as to possibly warrant criminal prosecution, the court denied the borrowers' request for rescission. Rescission may be a statutory remedy, but it is still an equitable remedy subject to equitable defenses.

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