July 30, 2010

Topics In This Issue

Federal Issues

Federal Agencies Issue Final SAFE Act Rules; Letter Urges HUD to Issue SAFE Act Guidance. On July 28, federal agencies issued final rules regarding the registration of employees who act as mortgage loan originators (MLOs) at banks, savings associations, Farm Credit System institutions, credit unions, and certain of their subsidiaries (collectively, Banking Institutions), as required by the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act). The final rule was issued by the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of Thrift Supervision, Farm Credit Administration, and National Credit Union Administration (the Federal Agencies). The SAFE Act requires MLOs employed by Banking Institutions to register with the Nationwide Mortgage Licensing System and Registry (NMLS&R). The Federal Agencies' final rule generally defines an MLO as an individual who (i) takes a residential mortgage loan application *and* (ii) offers or negotiates terms of a residential mortgage loan for compensation or gain. Notably, this definition of is more narrow than the definition of an MLO contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act. The final rule excludes from its registration requirement both individuals engaged in mortgage loan modifications and assumptions as well as individuals who service mortgage loans, provided that such individuals do not also originate new loans. The final rule will be effective October 1, 2010; however, the Federal Agencies do not expect that the NMLS&R will be ready to accept MLO registration applications before January 28, 2011. MLO employees of Banking Institutions will have 180 days to register and obtain unique identifiers after the NMLS&R begins accepting MLO applications. For a copy of the final rule, please click here. Additionally, on July 22, Representatives Barney Frank (D-MA) and Spencer Bachus (R-AL), the Chairman and Ranking Member of the House Financial Services Committee, issued a letter to the Secretary of the U.S. Department of Housing and Urban Development (HUD) urging HUD to issue guidance to states regarding implementation of the SAFE Act. The letter also urges HUD to provide guidance addressing the concerns of manufactured housing retailers and advocates a *de minimis* standard for registration and license requirements under the SAFE Act. For a copy of the letter, please click here.

FTC Issues Final Rule Regulating Debt Relief Services Practices. On July 29, the Federal Trade Commission (FTC) issued a final rule amending the Telemarketing Sales Rule (TSR) to address the telemarketing of debt relief services (*e.g.*, credit counseling, debt settlement, and debt negotiation services). The final rule, among other things, prohibits for-profit companies that market debt relief services over the telephone from charging a fee prior to settling or reducing a consumer's unsecured debt (*e.g.*, credit card debt). A fee can only be charged after the customer executes a written agreement that alters the terms of one of the consumer's debts (*e.g.*, a settlement, a renegotiation, etc.) and the consumer has made at least one payment to the creditor under the agreement. The rule also establishes how fees should be collected, and allows providers to require that customers place funds into a "dedicated bank account" to be used for the provider's fees and for payment to creditors. These provisions of the rule become effective October 27, 2010. The rule also (i) requires several debt relief-specific disclosures to consumers (*e.g.*, the amount of time necessary to achieve the represented results and the amount of savings needed before the settlement of the debt), (ii) prohibits specific misrepresentations as to material aspects of relief services (*e.g.*, the company's success rate), and (iii) extends the TSR to cover calls made by consumers to debt relief service companies in response to advertising. These provisions of the rule become effective September 27, 2010. For a copy of the *Federal Register* notice, please see http://www.ftc.gov/os/2010/07/R411001finalrule.pdf.

HUD's Mortgagee Review Board Publishes Notice Documenting Hundreds of Administrative Actions Against FHA-Approved Lenders. On July 26, the U.S. Department of Housing and Urban Development (HUD) issued a notice in the *Federal Register*describing administrative actions taken by its Mortgagee Review Board (MRB) from July 10, 2008 through March 18, 2010 against FHA-approved lenders who failed to meet certain HUD requirements. The notice lists the following:

- 32 actions against lenders that resulted in one or more of the following: civil money penalty; withdrawal of FHA approval; suspension, probation; reprimand; and entry into a settlement agreement;
- 905 lenders that were suspended for a year because they failed to meet the requirements for annual recertification; and
- 147 lenders that were required to pay a $3,500 penalty for failing to timely meet the requirements for annual recertification.

HUD separately revealed that, thus far in 2010, the MRB has issued nearly 1,500 administrative sanctions against lenders, including reprimands, probations, suspensions, withdrawals of approval, and civil money penalties. For a copy of the *Federal Register* notice, please click here; for a copy of HUD's press release, please see http://1.usa.gov/aGi8ze.

Federal Reserve Board Adjusts Fee-Based HOEPA Trigger to $592. On July 30, the Federal Reserve Board (FRB) announced its annual adjustment to the Home Ownership and Equity Protection Act (HOEPA) fee-based trigger. The new dollar amount for 2011—which is based on the annual percentage change reflected in the Consumer Price Index in effect on June 1, 2010—is $592. The adjustment becomes effective January 1, 2011. The adjustment does not affect the rules for "higher-priced mortgage loans" adopted by the FRB in July 2008; coverage of loans under those rules is determined using a rate-based trigger. For a copy of the press release, please click here.

TARP Special Master Does Not Seek Reimbursement for Executive Compensation Payments. On July 23, Kenneth R. Feinberg, Special Master for Troubled Asset Relief Program (TARP) Executive Compensation, announced that he had completed his review of executive pay from late 2008 through early 2009. The review was mandated by the American Recovery and Reinvestment Act, which expanded upon the Emergency Economic Stabilization Act's executive compensation rules for recipients of financial assistance under TARP. The Special Master's review examined payments to the "Top 25" executives at 419 firms that received TARP funding. Based on his review, the Special Master did not determine that payments any payments were "contrary to the 'public interest'" and, therefore, did not seek to negotiate reimbursement. The Special Master has proposed that firms voluntarily adopt a prospective compensation policy that, among other things, would authorize a firm "to restructure, reduce or cancel" pending payments to executives in a crisis situation, regardless of whether such payments were "guaranteed.'" For a copy of the announcement, please click here.

FTC Settles Charges Against "Foreclosure Rescue Services" Company. On July 29, the Federal Trade Commission (FTC) announced that Home Assure LLC, a company that purportedly offered "foreclosure rescue services" to homeowners, will pay $2.4 million to settle charges of various deceptive acts. According to the FTC's charges, the company did little or nothing to help consumers avoid foreclosure, collected up-front fees, and falsely claimed that it maintained favorable relationships with lenders that would enable it to obtain foreclosure relief and had successfully helped thousands of consumers avoid foreclosure. The FTC further charged that the company frequently refused to pay refunds on its inadequate services. The settlement, in addition to requiring the $2.4 million payment, bans the company from selling mortgage loan modification and foreclosure relief services in the future. For a copy of the press release, please see http://www.ftc.gov/opa/2010/07/homeassure.shtm. For more information, please see http://www.ftc.gov/os/caselist/0823192/index.shtm.

FTC Settles Charges Against Marketers of Mortgage Relief Services. On July 26, the Federal Trade Commission (FTC) announced settlements of three actions against marketers of mortgage relief services, requiring the payment of a total of $23 million. In all three actions, the FTC charged that the marketers had obtained up-front fees by falsely promising consumers that they could obtain mortgage loan modifications or prevent foreclosure. In most cases, the marketers failed to obtain any loan modifications for the consumers, and some consumers lost their homes while waiting for the promised results. The defendants in all three actions are permanently banned from, among other activities, selling mortgage modification or foreclosure relief services. For a copy of the press release, please click here. For more information, please click here.

State Issues

Illinois Passes Law Requiring Courts to Set Aside Certain Judicial Sales Related to HAMP. On July 23, Illinois Governor Pat Quinn signed HB5735, a bill requiring courts to set aside judicial sales of real estate under certain circumstances. Under the law, if a mortgagor can prove prior to confirmation of the sale that he or she had applied for assistance under the Home Affordable Modification Program (HAMP), and that the judicial sale materially violated HAMP's procedural requirements, then the court must set the sale aside. The bill is effective immediately. For a copy of the bill, please click here.

New Jersey Extends Expiration Date of Mortgage Licenses. On July 26, Thomas Considine, Commissioner of the New Jersey Department of Banking and Insurance, issued an order stating that because of delays in processing applications for licenses under the New Jersey Residential Mortgage Lending Act (RMLA) (New Jersey's Secure and Fair Enforcement for Mortgage Licensing Act compliance law), the expiration date of the licenses and registrations of all individuals and business entities licensed or registered under prior New Jersey law would be extended to October 31, 2010 for individuals and entities that had applied for licensure under the RMLA by July 31, 2010. For a copy of the order, please click here.

Illinois Regulator Revokes Residential Mortgage Lender License Due to High Rate of Defaults, Foreclosures on FHA Loans. On July 19, the Illinois Department of Financial and Professional Regulation (Illinois DFPR) revoked the mortgage lender license of Tamayo Financial Services, Inc. (TFSI) and assessed a $100,000 fine against the company. The order was issued in response to an investigation by the Illinois DFPR's Mortgage Fraud Task Force, which found that TFSI had default and claims rates on FHA loans nearly three times the national rate. The Illinois DFPR found that TFSI failed to verify borrowers' reasonable ability to repay loans, and that some of its borrowers had debt-to-income ratios well above 50%. According to the order, TFSI also permitted borrowers to sign disclosure forms that were blank, failed to report requests for loan repurchases, and failed to report its loan modification activities. For more information, please see http://www.idfpr.com/newsrls/07192010TamayoPressRelease.asp.

Courts

Ninth Circuit Holds Fixed APR in Credit Card Solicitation May Be Misleading To Consumers. On July 21, the U.S. Court of Appeals for the Ninth Circuit held that a plaintiff properly alleged claims under the Truth in Lending Act (TILA) and the California Unfair Competition Law (UCL) because the use of the term "fixed" to describe an annual percentage rate (APR) along with an enumeration of three specific exceptions may have been misleading to a consumer when the APR was also subject to change for other reasons. *Rubio v. Capital One Bank*, No. 08-56544, 2010 WL 2836994 (9th Cir. July 21, 2010). In *Rubio*, the plaintiff consumer applied for and received a credit card pursuant to a direct-mail solicitation from the defendant bank in 2004. The solicitation's "Schumer Box," as required by federal law, described the credit card's APR as a "fixed rate of 6.99%." A paragraph below the Schumer Box stated that the APR was subject to increase in the case of (i) a failure to make a payment when due, (ii) an overlimit account, and/or (iii) a returned payment. When the consumer received her credit card, she also received a Cardholder Agreement that contained a reservation of the right of the bank to "amend or change any part" of the agreement "at any time." While none of the three enumerated conditions occurred, three years later the consumer received notice from the bank that her APR would increase. The consumer subsequently filed suit against the bank, alleging violations of TILA and the UCL and asserting a breach of contract claim.

In concluding that the bank's disclosure was misleading under TILA, the Ninth Circuit relied in part on a study conducted by the Federal Reserve Board, which found that consumers "frequently assume that a rate that is labeled 'fixed' cannot be changed for any reason." Based in part on the same study, the Federal Reserve Board recently promulgated revisions to Regulation Z, which, as of July 1, 2010, bar the use of the term "fixed" in the Schumer box in certain circumstances. While those regulations did not apply retroactively to this case, the Ninth Circuit found them persuasive in determining that the disclosure at issue should be viewed as misleading. The Ninth Circuit reasoned that a reasonable consumer could conclude that the APR was "'unchangeable' except for the three exceptions" listed next to the Schumer box and that it was, thus, reasonable for a consumer to conclude that the three enumerated conditions tied to the Schumer box were identified "*precisely* because they were the only reasons that the APR could change." The Ninth Circuit further held that the misleading nature of the disclosure as measured under TILA's standards was sufficient to state a claim under the UCL. For a copy of the opinion, please see http://www.ca9.uscourts.gov/datastore/opinions/2010/07/21/08-56544.pdf.

Sixth Circuit Upholds Dismissal of Public Nuisance Suit Against Subprime Lending Financiers. On July 27, the U.S. Court of Appeals for the Sixth Circuit affirmed the dismissal of a public nuisance claim brought by plaintiff City of Cleveland, Ohio against a group of 22 businesses that financed subprime lending to city residents. *City of Cleveland v. Ameriquest Mort. Securities*, No. 09-3608, 2010 WL 2901049 (6th Cir. July 27, 2010). The city alleged that this financing was a public nuisance that led to the foreclosure crisis, thereby harming the city by decreasing its property tax base and prompting increased expenditures for fire/police responses to incidents at foreclosed properties. The defendants removed the suit from Ohio state court to federal court on diversity grounds, where the claim was later dismissed for failure to state a claim on four separate grounds. On appeal, the Sixth Circuit found that the city's claim failed to plead proximate cause because its complaint did not allege any direct relation between its injury and the defendants' purportedly tortious conduct. This finding was sufficient to compel dismissal and, accordingly, the court did not address the three alternative grounds identified by the district court. For a copy of the opinion, please see http://www.ca6.uscourts.gov/opinions.pdf/10a0222p-06.pdf.

Seventh Circuit Holds Servicer's Offer to Discuss Foreclosure Alternatives Falls Within the Scope of FDCPA. On July 27, the U.S. Court of Appeals for the Seventh Circuit held that correspondence sent by a servicer to a borrower offering to discuss foreclosure alternatives was a communication subject to the requirements of the Fair Debt Collection Practices Act (FDCPA).*Gburek v. Litton Loan Servicing LP*, No. 08-3776, 2010 WL 2899110 (7th Cir. July 27, 2010). In *Gburek*, after the plaintiff borrower defaulted on her mortgage loan, the defendant servicer directed two letters to her that offered to discuss ways of avoiding foreclosure; the letters also asked for her current financial information. The first letter came from the servicer directly and the second letter came from a firm that the servicer had partnered with to reach out to borrowers facing foreclosure. The borrower then filed a class action complaint against the servicer, alleging that the servicer's conduct violated the FDCPA. The district court held that the servicer's conduct did not violate the FDCPA because neither letter contained an explicit demand for payment of the debt and, thus, did not constitute a communication made in connection with the collection of a debt (one of the threshold criteria for FDCPA coverage). In reversing the district court's decision, the Seventh Circuit emphasized that there is not "a categorical rule that only an explicit demand for payment will qualify as a communication made in connection with the collection of a debt." Instead, according to the court, the presence of an explicit demand is only one of several factors to be considered; the other factors include whether the purpose and context of the communication, viewed objectively, indicate that it was made to induce a borrower to settle a debt. Because there were sufficient facts confirming that the servicer had reached out to the borrower to induce her to settle her mortgage loan debt (including by its partnership with the firm that sent the borrower the second letter), the Seventh Circuit reversed the decision of the district court. The Seventh Circuit declined to rule on the servicer's alternative argument that the communications did not violate the FDCPA's provisions, leaving that issue to be decided by the district court. For a copy of the opinion, please click here.

Fifth Circuit Holds Variable Rate Home Equity Loan Did Not Violate Texas Constitution. On July 22, the U.S. Court of Appeals for the Fifth Circuit affirmed a decision by a Texas district court finding that the terms of an adjustable rate home equity loan did not violate the Texas Constitution. *Cerda v. 2004-EQR1 L.L.C.*, No. 09-50619, 2010 WL 2853651 (5th Cir. July 22, 2010). In response to a foreclosure proceeding, the plaintiff borrowers in *Cerda* alleged that the terms of a 2002 home equity loan refinance violated the Texas Constitution because (i) it was issued in violation of a mandated waiting period of 12 days between submission of an "application" and closing, (ii) it called for monthly payments that were not "substantially equal," and (iii) it required the payment of fees in excess of a 3% cap. The district court rejected these arguments and, following a bench trial, granted judgment to the defendants. The Fifth Circuit affirmed in all respects. First, the court held that an oral application, which the borrowers indisputably made over the telephone more than 12 days before the loan closed, was sufficient to commence the required waiting period. Second, with respect to the Texas Constitution's requirement that scheduled payments on home equity loans be "substantially equal" in amount, the Fifth Circuit recognized that the provision was "in some tension with" a separate provision explicitly permitting "variable rate[s] of interest." The Fifth Circuit reconciled the provisions by holding that, in combination, the provisions merely required that home equity loans fully amortize - *i.e.*, that installments extinguish principal and interest over the life of the loan - and, in addition, that there be no final, "balloon" payment. Because the plaintiffs' loan comported with these requirements, the Fifth Circuit held that the "substantially equal" provision had not been violated. Third, the Fifth Circuit held that the loan did not exceed a 3% cap on fees, reasoning that the yield spread premium on the loan was not a "fee" because it was paid by the lender - not the borrower - to the broker, and that discount points are properly considered to be interest rather than a fee subject to the cap. As the Fifth Circuit noted, its rulings were based on the Texas Constitution as of 2002. Since that time, certain provisions at issue in this case have been amended. For a copy of the opinion, please see http://www.ca5.uscourts.gov/opinions/pub/09/09-50619-CV0.wpd.pdf.

California Federal Court Denies Bank's Motion to Dismiss Based on HOLA Preemption. On July 19, the U.S. District Court for the Northern District of California held that the Home Owners' Loan Act (HOLA) and Office of Thrift Supervision (OTS) regulations may not preempt various state law claims in a suit arising from a mortgage loan refinance transaction originated by a federal savings association. *Lopez v. Wachovia Mortgage*, No. 10-01645, 2010 WL 2836823 (N.D. Cal. July 19, 2010). In *Lopez*, the plaintiff borrower refinanced a mortgage loan through the defendant, a federal savings association regulated by the OTS. After the transaction was completed, the borrower discovered that the loan was a 2-year fixed rate loan where the monthly payments would increase $200 per month and not a 30-year, fixed rate loan, as the borrower claimed that he had intended to obtain. The borrower brought various claims under California law, including unconscionable contract, unfair or deceptive acts or practices, and fraud. Although the court granted a motion to dismiss by the thrift based on the inadequacy of the plaintiff's state law allegations, the court granted leave to replead rather than accepting the thrift's independent argument that the claims should be dismissed on preemption grounds. The court found that the California state laws that prohibit misrepresentations are laws that apply generally to contracts and commercial laws and only incidentally affect the lending operations of a federal savings association. As such, the laws fall within express exceptions to the broad preemption scheme set forth in HOLA and the OTS regulations. The court stated that it would be premature to rule on the preemption issue until the borrower amended her claims, and that a trial might then be necessary to make a factual determination as to whether the effects of the state rules on the business of lending of the bank were indeed incidental. For a copy of the opinion, please click here.

California Supreme Court Holds Private Counsel Can Participate on a Contingent-Fee Basis in Public-Nuisance Abatement Lawsuits. On July 26, the California Supreme Court held that private counsel can participate on a contingent-fee basis in certain public-nuisance abatement lawsuits brought in the name of a public entity if the retainer agreement with private counsel specifies that (i) control and supervision of the case will be retained by government attorneys, (ii) government attorneys will retain a veto power over all decisions made by outside counsel, and (iii) a government attorney with supervisory authority will be personally involved in overseeing the litigation. *County of Santa Clara v. Superior Court*, No. S163681, 2010 WL 2890318 (Cal. 2010). In reaching this result, the court narrowed the holding in *People ex rel. Clancy v. Superior Court*, 39 Cal.3d 740 (Cal. 1985), which suggested that a bright-line rule barred attorneys with a financial interest in the outcome of a case from representing the interests of the public in any public nuisance prosecution. The court explained, however, that such a bright-line rule could still apply to prohibit participation by private attorneys on a contingent-fee basis in public nuisance actions that implicate fundamental constitutional interests, threaten ongoing business activity, or carry the threat of criminal liability. For a copy of the opinion, please click here.

Firm News

Clint Rockwell and Jonathan Cannon will be speaking on "Buyback Defense Strategies and RESPA Developments" at the Lenders One Summer Conference in Rancho Palos Verdes, CA on August 3.

Jonice Gray Tucker will be speaking on issues related "Fair Servicing" at the American Bar Association's Annual Meeting on August 7.

Jonice Gray Tucker will be speaking at the California Mortgage Bankers Association's Servicing Conference on August 9. The topic is enforcement activity related to loan modifications and default servicing.

[Andrew Sandler](#) will be the chairperson for Banking Crisis Fallout 2010 at PLI New York Center in New York City on November 4; the topic will be Emerging Enforcement Trends.

[Andrew Sandler](#) participated in a webinar by Thomson Reuters, "Enforcement, Governance & Consumer Protection," on July 26.

[Andrew Sandler](#) participated in a webinar by the American Bankers Association, "How Financial Regulatory Reform Legislation Will Impact Banks," on July 28.

[Andrew Sandler](#) recently participated in four webinars offered by the Financial Services Roundtable on the topic "The Restoring American Financial Stability Act of 2010: Legislative Reform Meets Regulatory Reality."

Mortgages

Federal Agencies Issue Final SAFE Act Rules; Letter Urges HUD to Issue SAFE Act Guidance. On July 28, federal agencies issued final rules regarding the registration of employees who act as mortgage loan originators (MLOs) at banks, savings associations, Farm Credit System institutions, credit unions, and certain of their subsidiaries (collectively, Banking Institutions), as required by the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (SAFE Act). The final rule was issued by the Office of the Comptroller of the Currency, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of Thrift Supervision, Farm Credit Administration, and National Credit Union Administration (the Federal Agencies). The SAFE Act requires MLOs employed by Banking Institutions to register with the Nationwide Mortgage Licensing System and Registry (NMLS&R). The Federal Agencies' final rule generally defines an MLO as an individual who (i) takes a residential mortgage loan application *and* (ii) offers or negotiates terms of a residential mortgage loan for compensation or gain. Notably, this definition of is more narrow than the definition of an MLO contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act. The final rule excludes from its registration requirement both individuals engaged in mortgage loan modifications and assumptions as well as individuals who service mortgage loans, provided that such individuals do not also originate new loans. The final rule will be effective October 1, 2010; however, the Federal Agencies do not expect that the NMLS&R will be ready to accept MLO registration applications before January 28, 2011. MLO employees of Banking Institutions will have 180 days to register and obtain unique identifiers after the NMLS&R begins accepting MLO applications. [For a copy of the final rule, please click here](#). Additionally, on July 22, Representatives Barney Frank (D-MA) and Spencer Bachus (R-AL), the Chairman and Ranking Member of the House Financial Services Committee, issued a letter to the Secretary of the U.S. Department of Housing and Urban Development (HUD) urging HUD to issue guidance to states regarding implementation of the SAFE Act. The letter also urges HUD to provide guidance addressing the concerns of manufactured housing retailers and advocates a *de minimis* standard for registration and license requirements under the SAFE Act. [For a copy of the letter, please click here](#).

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California Federal Court Denies Bank's Motion to Dismiss Based on HOLA Preemption. On July 19, the U.S. District Court for the Northern District of California held that the Home Owners' Loan Act (HOLA) and Office of Thrift Supervision (OTS) regulations may not preempt various state law claims in a suit arising from a mortgage loan refinance transaction originated by a federal savings association. *Lopez v. Wachovia Mortgage*, No. 10-01645, 2010 WL 2836823 (N.D. Cal. July 19, 2010). In *Lopez*, the plaintiff borrower refinanced a mortgage loan through the defendant, a federal savings association regulated by the OTS. After the transaction was completed, the borrower discovered that the loan was a 2-year fixed rate loan where the monthly payments would increase $200 per month and not a 30-year, fixed rate loan, as the borrower claimed that he had intended to obtain. The borrower brought various claims under California law, including unconscionable contract, unfair or deceptive acts or practices, and fraud. Although the court granted a motion to dismiss by the thrift based on the inadequacy of the plaintiff's state law allegations, the court granted leave to replead rather than accepting the thrift's independent argument that the claims should be dismissed on preemption grounds. The court found that the California state laws that prohibit misrepresentations are laws that apply generally to contracts and commercial laws and only incidentally affect the lending operations of a federal savings association. As such, the laws fall within express exceptions to the broad preemption scheme set forth in HOLA and the OTS regulations. The court stated that it would be premature to rule on the preemption issue until the borrower amended her claims, and that a trial might then be necessary to make a factual determination as to whether the effects of the state rules on the business of lending of the bank were indeed incidental. For a copy of the opinion, please click here.

Banking

TARP Special Master Does Not Seek Reimbursement for Executive Compensation Payments. On July 23, Kenneth R. Feinberg, Special Master for Troubled Asset Relief Program (TARP) Executive Compensation, announced that he had completed his review of executive pay from late 2008 through early 2009. The review was mandated by the American Recovery and Reinvestment Act, which expanded upon the Emergency Economic Stabilization Act's executive compensation rules for recipients of financial assistance under TARP. The Special Master's review examined payments to the "Top 25" executives at 419 firms that received TARP funding. Based on his review, the Special Master did not determine that payments any payments were "contrary to the 'public interest'" and, therefore, did not seek to negotiate reimbursement. The Special Master has proposed that firms voluntarily adopt a prospective compensation policy that, among other things, would authorize a firm "to restructure, reduce or cancel" pending payments to executives in a crisis situation, regardless of whether such payments were "guaranteed.'" For a copy of the announcement, please click here.

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Consumer Finance

FTC Issues Final Rule Regulating Debt Relief Services Practices. On July 29, the Federal Trade Commission (FTC) issued a final rule amending the Telemarketing Sales Rule (TSR) to address the telemarketing of debt relief services (*e.g.*, credit counseling, debt settlement, and debt negotiation services). The final rule, among other things, prohibits for-profit companies that market debt relief services over the telephone from charging a fee prior to settling or reducing a consumer's unsecured debt (*e.g.*, credit card debt). A fee can only be charged after the customer executes a written agreement that alters the terms of one of the consumer's debts (*e.g.*, a settlement, a renegotiation, etc.) and the consumer has made at least one payment to the creditor under the agreement. The rule also establishes how fees should be collected, and allows providers to require that customers place funds into a "dedicated bank account" to be used for the provider's fees and for payment to creditors. These provisions of the rule become effective October 27, 2010. The rule also (i) requires several debt relief-specific disclosures to consumers (*e.g.*, the amount of time necessary to achieve the represented results and the amount of savings needed before the settlement of the debt), (ii) prohibits specific misrepresentations as to material aspects of relief services (*e.g.*, the company's success rate), and (iii) extends the TSR to cover calls made by consumers to debt relief service companies in response to advertising. These provisions of the rule become effective September 27, 2010. For a copy of the *Federal Register* notice, please see http://www.ftc.gov/os/2010/07/R411001finalrule.pdf.

Seventh Circuit Holds Servicer's Offer to Discuss Foreclosure Alternatives Falls Within the Scope of FDCPA. On July 27, the U.S. Court of Appeals for the Seventh Circuit held that correspondence sent by a servicer to a borrower offering to discuss foreclosure alternatives was a communication subject to the requirements of the Fair Debt Collection Practices Act (FDCPA).*Gburek v. Litton Loan Servicing LP*, No. 08-3776, 2010 WL 2899110 (7th Cir. July 27, 2010). In *Gburek*, after the plaintiff borrower defaulted on her mortgage loan, the defendant servicer directed two letters to her that offered to discuss ways of avoiding foreclosure; the letters also asked for her current financial information. The first letter came from the servicer directly and the second letter came from a firm that the servicer had partnered with to reach out to borrowers facing foreclosure. The borrower then filed a class action complaint against the servicer, alleging that the servicer's conduct violated the FDCPA. The district court held that the servicer's conduct did not violate the FDCPA because neither letter contained an explicit demand for payment of the debt and, thus, did not constitute a communication made in connection with the collection of a debt (one of the threshold criteria for FDCPA coverage). In reversing the district court's decision, the Seventh Circuit emphasized that there is not "a categorical rule that only an explicit demand for payment will qualify as a communication made in connection with the collection of a debt." Instead, according to the court, the presence of an explicit demand is only one of several factors to be considered; the other factors include whether the purpose and context of the communication, viewed objectively, indicate that it was made to induce a borrower to settle a debt. Because there were sufficient facts confirming that the servicer had reached out to the borrower to induce her to settle her mortgage loan debt (including by its partnership with the firm that sent the borrower the second letter), the Seventh Circuit reversed the decision of the district court. The Seventh Circuit declined to rule on the servicer's alternative argument that the communications did not violate the FDCPA's provisions, leaving that issue to be decided by the district court. For a copy of the opinion, please click here.

Fifth Circuit Holds Variable Rate Home Equity Loan Did Not Violate Texas Constitution. On July 22, the U.S. Court of Appeals for the Fifth Circuit affirmed a decision by a Texas district court finding that the terms of an adjustable rate home equity loan did not violate the Texas Constitution. *Cerda v. 2004-EQR1 L.L.C.*, No. 09-50619, 2010 WL 2853651 (5th Cir. July 22, 2010). In response to a foreclosure proceeding, the plaintiff borrowers in *Cerda* alleged that the terms of a 2002 home equity loan refinance violated the Texas Constitution because (i) it was issued in violation of a mandated waiting period of 12 days between submission of an "application" and closing, (ii) it called for monthly payments that were not "substantially equal," and (iii) it required the payment of fees in excess of a 3% cap. The district court rejected these arguments and, following a bench trial, granted judgment to the defendants. The Fifth Circuit affirmed in all respects. First, the court held that an oral application, which the borrowers indisputably made over the telephone more than 12 days before the loan closed, was sufficient to commence the required waiting period. Second, with respect to the Texas Constitution's requirement that scheduled payments on home equity loans be "substantially equal" in amount, the Fifth Circuit recognized that the provision was "in some tension with" a separate provision explicitly permitting "variable rate[s] of interest." The Fifth Circuit reconciled the provisions by holding that, in combination, the provisions merely required that home equity loans fully amortize - *i.e.*, that installments extinguish principal and interest over the life of the loan - and, in addition, that there be no final, "balloon" payment. Because the plaintiffs' loan comported with these requirements, the Fifth Circuit held that the "substantially equal" provision had not been violated. Third, the Fifth Circuit held that the loan did not exceed a 3% cap on fees, reasoning that the yield spread premium on the loan was not a "fee" because it was paid by the lender - not the borrower - to the broker, and that discount points are properly considered to be interest rather than a fee subject to the cap. As the Fifth Circuit noted, its rulings were based on the Texas Constitution as of 2002. Since that time, certain provisions at issue in this case have been amended. For a copy of the opinion, please see http://www.ca5.uscourts.gov/opinions/pub/09/09-50619-CV0.wpd.pdf.

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Litigation

Ninth Circuit Holds Fixed APR in Credit Card Solicitation May Be Misleading To Consumers. On July 21, the U.S. Court of Appeals for the Ninth Circuit held that a plaintiff properly alleged claims under the Truth in Lending Act (TILA) and the California Unfair Competition Law (UCL) because the use of the term "fixed" to describe an annual percentage rate (APR) along with an enumeration of three specific exceptions may have been misleading to a consumer when the APR was also subject to change for other reasons. *Rubio v. Capital One Bank*, No. 08-56544, 2010 WL 2836994 (9th Cir. July 21, 2010). In *Rubio*, the plaintiff consumer applied for and received a credit card pursuant to a direct-mail solicitation from the defendant bank in 2004. The solicitation's "Schumer Box," as required by federal law, described the credit card's APR as a "fixed rate of 6.99%." A paragraph below the Schumer Box stated that the APR was subject to increase in the case of (i) a failure to make a payment when due, (ii) an overlimit account, and/or (iii) a returned payment. When the consumer received her credit card, she also received a Cardholder Agreement that contained a reservation of the right of the bank to "amend or change any part" of the agreement "at any time." While none of the three enumerated conditions occurred, three years later the consumer received notice from the bank that her APR would increase. The consumer subsequently filed suit against the bank, alleging violations of TILA and the UCL and asserting a breach of contract claim.

In concluding that the bank's disclosure was misleading under TILA, the Ninth Circuit relied in part on a study conducted by the Federal Reserve Board, which found that consumers "frequently assume that a rate that is labeled 'fixed' cannot be changed for any reason." Based in part on the same study, the Federal Reserve Board recently promulgated revisions to Regulation Z, which, as of July 1, 2010, bar the use of the term "fixed" in the Schumer box in certain circumstances. While those regulations did not apply retroactively to this case, the Ninth Circuit found them persuasive in determining that the disclosure at issue should be viewed as misleading. The Ninth Circuit reasoned that a reasonable consumer could conclude that the APR was "'unchangeable' except for the three exceptions" listed next to the Schumer box and that it was, thus, reasonable for a consumer to conclude that the three enumerated conditions tied to the Schumer box were identified "*precisely* because they were the only reasons that the APR could change." The Ninth Circuit further held that the misleading nature of the disclosure as measured under TILA's standards was sufficient to state a claim under the UCL. For a copy of the opinion, please see http://www.ca9.uscourts.gov/datastore/opinions/2010/07/21/08-56544.pdf.

Sixth Circuit Upholds Dismissal of Public Nuisance Suit Against Subprime Lending Financiers. On July 27, the U.S. Court of Appeals for the Sixth Circuit affirmed the dismissal of a public nuisance claim brought by plaintiff City of Cleveland, Ohio against a group of 22 businesses that financed subprime lending to city residents. *City of Cleveland v. Ameriquest Mort. Securities*, No. 09-3608, 2010 WL 2901049 (6th Cir. July 27, 2010). The city alleged that this financing was a public nuisance that led to the foreclosure crisis, thereby harming the city by decreasing its property tax base and prompting increased expenditures for fire/police responses to incidents at foreclosed properties. The defendants removed the suit from Ohio state court to federal court on diversity grounds, where the claim was later dismissed for failure to state a claim on four separate grounds. On appeal, the Sixth Circuit found that the city's claim failed to plead proximate cause because its complaint did not allege any direct relation between its injury and the defendants' purportedly tortious conduct. This finding was sufficient to compel dismissal and, accordingly, the court did not address the three alternative grounds identified by the district court. For a copy of the opinion, please see http://www.ca6.uscourts.gov/opinions.pdf/10a0222p-06.pdf.

Seventh Circuit Holds Servicer's Offer to Discuss Foreclosure Alternatives Falls Within the Scope of FDCPA. On July 27, the U.S. Court of Appeals for the Seventh Circuit held that correspondence sent by a servicer to a borrower offering to discuss foreclosure alternatives was a communication subject to the requirements of the Fair Debt Collection Practices Act (FDCPA).*Gburek v. Litton Loan Servicing LP*, No. 08-3776, 2010 WL 2899110 (7th Cir. July 27, 2010). In *Gburek*, after the plaintiff borrower defaulted on her mortgage loan, the defendant servicer directed two letters to her that offered to discuss ways of avoiding foreclosure; the letters also asked for her current financial information. The first letter came from the servicer directly and the second letter came from a firm that the servicer had partnered with to reach out to borrowers facing foreclosure. The borrower then filed a class action complaint against the servicer, alleging that the servicer's conduct violated the FDCPA. The district court held that the servicer's conduct did not violate the FDCPA because neither letter contained an explicit demand for payment of the debt and, thus, did not constitute a communication made in connection with the collection of a debt (one of the threshold criteria for FDCPA coverage). In reversing the district court's decision, the Seventh Circuit emphasized that there is not "a categorical rule that only an explicit demand for payment will qualify as a communication made in connection with the collection of a debt." Instead, according to the court, the presence of an explicit demand is only one of several factors to be considered; the other factors include whether the purpose and context of the communication, viewed objectively, indicate that it was made to induce a borrower to settle a debt. Because there were sufficient facts confirming that the servicer had reached out to the borrower to induce her to settle her mortgage loan debt (including by its partnership with the firm that sent the borrower the second letter), the Seventh Circuit reversed the decision of the district court. The Seventh Circuit declined to rule on the servicer's alternative argument that the communications did not violate the FDCPA's provisions, leaving that issue to be decided by the district court. For a copy of the opinion, please click here.

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California Supreme Court Holds Private Counsel Can Participate on a Contingent-Fee Basis in Public-Nuisance Abatement Lawsuits. On July 26, the California Supreme Court held that private counsel can participate on a contingent-fee basis in certain public-nuisance abatement lawsuits brought in the name of a public entity if the retainer agreement with private counsel specifies that (i) control and supervision of the case will be retained by government attorneys, (ii) government attorneys will retain a veto power over all decisions made by outside counsel, and (iii) a government attorney with supervisory authority will be personally involved in overseeing the litigation. *County of Santa Clara v. Superior Court*, No. S163681, 2010 WL 2890318 (Cal. 2010). In reaching this result, the court narrowed the holding in *People ex rel. Clancy v. Superior Court*, 39 Cal.3d 740 (Cal. 1985), which suggested that a bright-line rule barred attorneys with a financial interest in the outcome of a case from representing the interests of the public in any public nuisance prosecution. The court explained, however, that such a bright-line rule could still apply to prohibit participation by private attorneys on a contingent-fee basis in public nuisance actions that implicate fundamental constitutional interests, threaten ongoing business activity, or carry the threat of criminal liability. For a copy of the opinion, please click here.

Credit Cards

FTC Issues Final Rule Regulating Debt Relief Services Practices. On July 29, the Federal Trade Commission (FTC) issued a final rule amending the Telemarketing Sales Rule (TSR) to address the telemarketing of debt relief services (*e.g.*, credit counseling, debt settlement, and debt negotiation services). The final rule, among other things, prohibits for-profit companies that market debt relief services over the telephone from charging a fee prior to settling or reducing a consumer's unsecured debt (*e.g.*, credit card debt). A fee can only be charged after the customer executes a written agreement that alters the terms of one of the consumer's debts (*e.g.*, a settlement, a renegotiation, etc.) and the consumer has made at least one payment to the creditor under the agreement. The rule also establishes how fees should be collected, and allows providers to require that customers place funds into a "dedicated bank account" to be used for the provider's fees and for payment to creditors. These provisions of the rule become effective October 27, 2010. The rule also (i) requires several debt relief-specific disclosures to consumers (*e.g.*, the amount of time necessary to achieve the represented results and the amount of savings needed before the settlement of the debt), (ii) prohibits specific misrepresentations as to material aspects of relief services (*e.g.*, the company's success rate), and (iii) extends the TSR to cover calls made by consumers to debt relief service companies in response to advertising. These provisions of the rule become effective September 27, 2010. For a copy of the *Federal Register* notice, please see http://www.ftc.gov/os/2010/07/R411001finalrule.pdf.

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We welcome reader comments and suggestions regarding issues or items of interest to be covered in future editions of InfoBytes.
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