CLIENT ALERT

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Massachusetts Foreclosure Procedures Threatened

A result that is troubling for residential mortgage creditors and servicers was entered by Bankruptcy Judge Robert Somma in a decision in the Massachusetts Bankruptcy Court case, *Robert H. Strayton v. Champion Mortgage*, Adversary Proceeding No. 06-1394-RS issued on January 17, 2007. The court allowed an injunction to stand which prohibits the completion of a previously conducted mortgage foreclosure sale pending final determination of the merits of the adversary proceeding. Of concern to the mortgage industry is the criticism of the foreclosure procedures the lender and its agents followed in conducting the foreclosure sale that is the subject of the case.

Debtor Plaintiff Robert Strayton (the "Debtor") and his wife acquired a condominium in 1998 which they occupied as their principal residence. They obtained a home equity line of credit from Champion Mortgage (the "Lender") in October 2002, secured by a second mortgage on the property. Following default under various forbearance agreements, a foreclosure sale was held on September 27, 2006. Four qualified bidders attended the foreclosure sale, bringing in a high bid of $130,000, subject to the $100,000 first mortgage debt. After valuation evidence presented at a Bankruptcy Court hearing, the Court entered a finding that the property had a fair market value of at least $325,000.

The Lender had given default and foreclosure notice to the Debtor and his wife by registered mail; published the statutorily required legal notice; placed two display ads in the auction section of *The Boston Herald* on two consecutive Sundays – all in accordance with the loan documents and Massachusetts foreclosure law. What is disturbing about the decision is that it states that the Lender did not do the following: market the property; obtain a current property appraisal; contact a broker for valuation and market information, or seek permission from the Debtor to allow potential buyers to inspect the property. Moreover, the court criticizes Lender's display advertising as "no more than a bulk notice" because it lumped multiple properties into one advertisement and because it limited the information about the property to no more than the address, date, location and time of the auction. The court described the Lender's foreclosure process as a "decidedly minimal foreclosure program", and labeled the testimony by the Lender's foreclosure attorney and auctioneer as "not helpful . . . [it] seemed more than usually self-serving and, in at least one instance, deliberately obtuse. The gist of their testimony is a somewhat lordly 'custom and practice' defense with little recognition or acknowledgment of the mandate of *Edry et al.*"

The 1996 Massachusetts Bankruptcy Court case of *In re Edry*, stands for the proposition that a foreclosing mortgagee must do more than comply with the procedure prescribed by the statute. The court also cites *In re LaPointe*, a case from the Bankruptcy Appellate Panel of the First Circuit which stands for the proposition that a foreclosing mortgagee must act in good faith and use reasonable diligence in conducting a foreclosure sale.

In allowing the injunction against completing the foreclosure sale to stand, the court found the lack of marketing, appraisal, and real estate broker contact; no inquiry into the market regarding either value or prospective buyers; and the failure to make inquiry into the availability of the property for pre-foreclosure inspections was "diligence not done" by the Lender. This "diligence not done" and the fact that if completed the foreclosure sale would result in significant value being lost to the bankruptcy estate, was enough for the court to find a substantial likelihood the Debtor would succeed on the merits in the action to invalidate the foreclosure sale. Lenders, servicers and their agents are forewarned; if Judge Somma's standards become industry practice, the expense of foreclosure will skyrocket. Even more troubling is the fact that this case will be cited in attempts by borrowers to invalidate previously completed foreclosure sales. The case has been appealed to the U.S. District Court.

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First Circuit Rules that TILA and MCCCDA Rescission Remedy is Not Available for Class Action Relief

The lending community welcomes a recent decision of the First Circuit Court of Appeals on January 29, 2007. In finding that class actions for rescission are unavailable under the federal Truth in Lending Act ("TILA") and the Massachusetts Consumer Credit Cost Disclosure Act ("MCCCDA"), the First Circuit reversed the U.S. District Court for the District of Massachusetts' certification of a broad class of plaintiffs made up of residential mortgage loan borrowers who might potentially be eligible for rescission relief. In the case of *Ralph McKenna et al. v. First Horizon Home Loan Corp.*, plaintiffs sought relief under TILA and MCCCDA, alleging that First Horizon Home Loan Corp. (the "Lender") failed to accurately disclose the plaintiffs' statutory right of rescission by issuing confusing and legally defective notices of rescission.

The regulations implementing TILA and MCCCDA do not require that creditors use the model forms for notice of the right to rescind which are prepared by the Federal Reserve Board as long as the creditor provides notice of the right to rescind that is "substantially similar" to the Board's forms. The Lender in *McKenna* did not use the model forms prepared by the Board, but instead provided the plaintiffs with its own form of notice. The Board's forms for rescission notice include Form H-8 which is meant for consumers who are entering into mortgage loan refinance transactions with a different lender than the one that financed the previous mortgage loan, and Form H-9 which is intended for consumers who are entering into mortgage loan refinance transactions with the same lender who financed the consumer's prior mortgage. The *McKenna* plaintiffs challenged the Lender's form as it applies to both types of transactions where the Lender is refinancing a prior loan from a different lender as well as to transactions where Lender is refinancing a prior mortgage loan that Lender made to the consumer.

In addition to their individual claims for rescission and statutory damages, the plaintiffs asked for similar relief for a class of Massachusetts consumers who had received mortgage loans from the Lender and similar rescission notices. The District Court adopted the recommendation of a magistrate judge certifying a class of consumers who obtained non-purchase money loans from the Lender on or after April 1, 2003; who received the allegedly defective notice of the right to cancel; where the loan is secured by the borrower's Massachusetts residence; where the loan was for purposes other than the initial construction or acquisition, and where all or part of the loan proceeds were used to refinance a loan made by a lender other than the Lender. The class definition also provided that no person shall be excluded from the class simply because that person has refinanced or paid off the loan.

The issue of whether class action relief is available in rescission cases is an issue of first impression in the First Circuit, resolved by the Fifth Circuit in the 1980 case *James v. Home Constr. Co. of Mobile, Inc.* The Fifth Circuit held that rescission class actions are not maintainable under the TILA, basing its holding primarily on a conclusion that Congress intended rescission to be a purely personal remedy, and purely personal remedies are inconsistent with class action remedies. The Fifth Circuit also noted the absence of any necessity for the class action type of remedy as there are considerable monetary recoveries and attorneys' fees available for plaintiffs in individual rescission cases.

In following the Fifth Circuit, the First Circuit notes that many District Courts have certified TILA rescission class actions on the theory that nothing in the TILA expressly prohibits class actions. Class actions, however, are specifically addressed in the TILA section that relates to damages with no mention of such relief in the rescission section. The class action section of TILA for damages provides a cap for damages ($500,000 or 1% of the creditor's net worth), and to that end the plaintiffs argued that Congress may have intended to allow rescission class actions to have no limitations in terms of the costs to be borne by the offending creditor.

In *McKenna*, the First Circuit notes that if plaintiffs are allowed to maintain an unrestricted class action for rescission claims, there is likely substantial recovery for plaintiffs as the Lender estimates its exposure at approximately $200,000,000. In addressing such a recovery, the First Circuit writes that "the notion that Congress would limit liability to $500,000 with respect to one remedy while allowing the sky to be the limit with respect to another remedy for the same violation strains credibility." The Court also points out that the plaintiffs tried to downplay the overall financial impact of the class action on the Lender in *McKenna*, but that "deeds speak louder than words" – in order to recruit additional class claimants, the plaintiffs' attorneys placed advertisements holding out prospective recoveries of $50,000 per person.

So the issue is now resolved in the First Circuit; class action relief is unavailable for rescission claims under the TILA and under the MCCCDA. Plaintiffs still have the protection found in the statutes which include substantial enforcement authority for federal and state agencies with jurisdiction over lending institutions, and individual rescission claims may be maintained privately by plaintiffs where sizable monetary rewards are still available.