

Recent Developments in Predatory Lending Litigation

The term “predatory lending” is applied broadly to a range of allegedly abusive lending practices, some (but not all) of which may violate state or federal statutes. Challenged practices include “flipping” or repeatedly refinancing a loan with additional fees, prepayment penalties that lock a subprime borrower into a higher interest rate even if his or her credit improves, and balloon payments at the end of a “high cost” loan when the remaining amount of principal becomes due.¹ Many predatory lending claims have been linked to subprime adjustable-rate mortgages (ARMs) with low, “teaser” rates that reset to higher rates after 2-3 years. For nearly one in five borrowers who took out ARMs between 2004 and 2006, the reset rate is at least 50% higher than the original payments.²

The rapid and largely unregulated growth of the subprime mortgage market has led to widespread and varied types of predatory lending claims, especially in underserved communities with inexperienced borrowers.³ Examples of recent predatory-lending complaints, listed by filing date, include:

January 18, 2007:

Hill et al. v. Countrywide Home Loans, Inc., Docket No.: 1:07-cv-00140-RHC (E.D. Tex., removed from Jefferson County District Court): The plaintiffs in this class action are Hurricanes Katrina and Rita victims who accepted Countrywide’s offer to defer payments of their mortgage loans, usually for at least 60 days. Countrywide allegedly told the plaintiffs that these missed payments could be made up at the end of the mortgage’s term. However, according to the Complaint, Countrywide instead demanded payment immediately after the deferral period, or required the plaintiffs to modify their loans on less favorable terms. The plaintiffs seek restitution, damages and injunctive relief for Countrywide’s alleged violations of the Texas Deceptive Trade Practices Act and for negligent misrepresentation.

January 10, 2008:

City of Cleveland v. Deutsche Bank Trust Co. et al., Docket No.: 1:2008cv00139 (N.D. Ohio, removed from Cuyahoga County Court of Common Pleas): In a landmark case testing a novel theory, Cleveland has brought public nuisance claims against 21 investment banks, alleging that their securitization of subprime mortgages fed the growth of predatory lending practices.⁴ The city alleges that the defendants focused their efforts to market subprime loans on Cleveland, then set “the stage for financial catastrophe” by

¹ Pennsylvania Human Relations Commission, *Unlawful Discriminatory Predatory Lending and Reverse Redlining Guidelines in Housing and Commercial Property*, available at http://sites.state.pa.us/PA_Exec/PHRC/publications/literature/LendingRedlining%20Guide.pdf.

² The Association of Community Organizations for Reform Now, *Foreclosure Exposure: A study of racial and income disparities in home mortgage lending in 172 American cities* (Sept. 5, 2007), available at <http://www.acorn.org/fileadmin/HMDA/2007/HMDAreport2007.pdf>.

³ See U.S. Department of Housing and Urban Development, *Unequal Burden: Income & Racial Disparities in Subprime Lending in America* (2000), available at <http://www.huduser.org/publications/fairhsg/unequal.html>.

⁴ The city of Baltimore has filed a similar Complaint against Wells Fargo Bank for violations of the Fair Housing Act. *Mayor and City Council of Baltimore v. Wells Fargo Bank, N.A.*, Docket No. 1:08-cv-00062-BEL (D. Md. filed Jan. 8, 2008). The Complaint is described in greater detail in *Recent Developments in Reverse Redlining Litigation*.

abandoning underwriting standards and offering teaser rates to consumers. The city claims that the resulting “epidemic of foreclosures” cost it hundreds of millions of dollars in a depleted tax base, increased police and fire protection, and demolition costs. One defendant recently filed a motion to dismiss for lack of personal jurisdiction, claiming that it has never originated, foreclosed on, or securitized a mortgage loan in Ohio.

The Truth in Lending Act:

Numerous provisions of the Truth in Lending Act, 15 U.S.C. § 1601 et seq., (TILA) have been the subject of recent litigation.⁵ A particularly high-stakes issue is whether a plaintiff who complains of TILA violations can bring a class action for rescission of all class members’ mortgages, or is instead limited to seeking damages. In 1974, Congress imposed a statutory cap limiting total class action damages under the TILA to the lesser of \$500,000 or one percent of a creditor’s net worth.⁶ However, no such limit exists for the remedy of rescission, and this type of action could expose creditors to substantially larger losses.⁷

In 1980, the Fifth Circuit declined to certify a class action seeking rescission as a remedy, reasoning that rescission is a “purely personal remedy” that cannot support a class claim. The court noted that permitting a class action would be inconsistent with Congressional intent and would not further the interests of class members. The court reasoned that class members would have inherent conflicts because class-wide rescission might lead to the lender’s insolvency (an event that would harm some or all class members) and because they could recover their own attorneys’ fees in individual actions.⁸

The plaintiffs in two recent cases, unlike those in the Fifth Circuit case, have sought declarations that class members would be able to rescind their loans.⁹ In 2007, the First Circuit held that class actions for declaratory relief were no different from those seeking rescission, noting that “the professed distinction between a suit for a declaratory judgment that rescission is possible and a suit for rescission simpliciter elevates form over substance.” The First Circuit followed the Fifth Circuit, holding that as a matter of law class actions for rescission cannot be pursued under the TILA.¹⁰

However, last year a Wisconsin District Court certified a class of borrowers seeking a declaration that they could rescind loans with Chevy Chase Bank.¹¹ That court distinguished the Fifth Circuit’s decision because, in a class action for declaratory relief, unlike in a suit for rescission itself, the individual plaintiffs’ personal circumstances only become relevant after the court’s judgment when they pursue a remedy. The court, however, granted the defendants’ request for a stay pending appeal to the Seventh

⁵ See *Williams v. Saxon Mortgage Co.*, Docket No. 06-0799-WS-B, 2008 WL 45739, at *1 & n.4 (S.D. Ala. Jan. 2, 2008) (the one-year limitations period for bringing a TILA action is not equitably tolled by the conduct that constituted the violation itself); *Newman v. Apex Financial Group Inc.*, No. 07 C 4475, 2008 WL 130924, at *7 (N.D. Ill. Jan. 11, 2008) (the holder of title to a mortgage, even if not a creditor or the assignee of a creditor, is properly joined as a defendant to a TILA claim).

⁶ See *Andrews v. Chevy Chase Bank, FSB*, 474 F. Supp. 2d 1006, 1008 (E.D. Wis. 2007); *McKenna et al v. First Horizon Home Loan Corp.*, 475 F.3d 418, 422 (1st Cir. 2007); 15 U.S.C. § 1640(a).

⁷ *McKenna*, 475 F.3d at 424.

⁸ *James v. Home Const. Co. of Mobile, Inc.*, 621 F.2d 727, 731 & n.7 (5th Cir. 1980).

⁹ See *Andrews*, 474 F. Supp. 2d at 1010; *McKenna*, 475 F.3d at 426.

¹⁰ *McKenna*, 475 F.3d at 426.

¹¹ *Andrews v. Chevy Chase Bank, FSB*, 240 F.R.D. 612, 624 (E.D. Wis. 2007).

Circuit.¹² The defendants filed an appeal in early 2007 which has now been pending for more than a year.¹³

¹² *Andrews*, 474 F. Supp. 2d at 1010.

¹³ *See id.*, Docket No. 05C0454, rule 7.4 expedited non-dispositive motion at 2 (E.D. Wis. Jan. 29, 2008).