Court Rulings Give Class-Action Cases More Teeth

Mortgage originators should prepare for a potential wave of litigation

By Alex Henderson

Mortgage originators need solid systems to assure regulatory compliance with a host of rules that are actively enforced by numerous industry regulators and law enforcers, including the Consumer Financial Protection Bureau (CFPB), the Federal Deposit Insurance Corp., the Office of the Comptroller of the Currency and the Department of Justice.

But compliance litigation is about to get worse — much worse — because the plaintiffs' lawyers are coming.

Typical residential borrowers rarely have the financial resources to spend on lawyers to litigate issues of alleged regulatory noncompliance on the part of mortgage originators. Likewise, plaintiff attorneys, working on contingency, also have traditionally had little incentive to pursue such cases, where damages to the borrower or potential borrower are minimal or nonexistent.

Recent federal court decisions that affect the course of class-action lawsuits, however, will likely encourage plaintiff attorneys to pay closer attention to litigation related to regulatory-compliance issues in the residential-mortgage arena. An increased ability for those attorneys to pursue class-action lawsuits could be a game changer.

To date, there have been two major hurdles to certifying, or allowing, class-action lawsuits to advance in the courts in cases involving regulatory noncompliance claims. First is the hurdle of showing that clients suffered actual damages because of a lender's noncompliance. Second is the hurdle of showing that the damages to each member of the class — which could involve hundreds or even thousands of people — are substantially similar.

The Edwards case

In the case of technical noncompliance with the Real Estate Settlement Procedures Act (RESPA) and the Truth in Lending Act (TILA) — two major laws covering mortgage lending — the certification hurdles have represented significant barriers to any potential class-action litigation. In the past, class-action complaints alleging that fees charged by mortgage originators violated TILA because they were not "bona fide and reasonable," for instance, had to be subjected to a loan-by-loan and fee-by-fee analysis to establish that a group of plaintiffs suffered substantially similar damages.

But this past August, the influential U.S. Court of Appeals for the Ninth Circuit in California issued an opinion in a case — Denise Edwards v. First American Corp. — that could alter the class-action landscape. Although Edwards was not overcharged, nor did she suffer actual damages, she filed a class-action lawsuit against First American claiming she was subjected to a title-insurance charge that represented an illegal kickback for settlement services in violation of RESPA. The claim stemmed from an allegation that title insurer First American overpaid for a minority-ownership interest in Tower City Title Agency LLC — and that Tower agreed to refer all title-insurance business to First American.

In ruling on an appeal in the Edwards case from a lower court, the Ninth Circuit held that if there was a "common scheme" by the First American board of directors to acquire title agencies for the purpose of referrals, borrowers using those title agencies could be included in a class-action claim. The Ninth Circuit also agreed with a friend-of-the-court brief filed in the case by the CFPB and found that the RESPA safe harbor does not apply when a company acquires an ownership interest in a vendor, nor does it permit such agreements to circumvent the prohibition on referral payments involving mortgage-settlement services, such as title insurance.

The federal appeals court also agreed with the CFPB's argument that RESPA does not require a proof that the allegedly unlawful referral was effective. This is important in considering mortgage-originator compliance. If a mortgage originator technically violates RESPA, even though the violation cannot be shown to have influenced the borrower's ultimate action, the originator can still become the target of class-action litigation.

Although the appeals-court ruling is specific in its language, referring only to RESPA's prohibition on unlawful kickbacks, there is no reason to believe that the potential for plaintiffs' attorneys to bring class-action cases for violations of RESPA, TILA and other similar statues and regulations will not be greatly expanded by this ruling.

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Alex Henderson is chief counsel of Teraverde Management Advisors and general manager of Teraverde's compliance-services unit — which serves the needs of banks, independent mortgage bankers and other financial institutions in compliance matters. Henderson has practiced law for more than 30 years and has extensive experience in the financial- institution arena. He was a managing partner of a law firm for 12 years and headed its financial practice group. Reach him at (855) 374-8862 or ahenderson@teraverde.com.

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The Spokeo case

Whether the U.S. Supreme Court ultimately agrees with the Ninth Circuit Court of Appeals reasoning in the Edwards case remains to be seen, but the high court's thinking will likely be hinted at in the case of Spokeo Inc. v. Robins. This past April, the Supreme Court agreed to review the decision of the Ninth Circuit in the Spokeo case. Although the case is generally talked about as a cutting-edge privacy case, it has huge implications for all compliance class actions.

In the case, Thomas Robins alleges that Spokeo Inc. violated his rights under the Fair Credit Reporting Act (FCRA), but he did not claim actual or imminent harm. FCRA requires consumer-reporting agencies to "follow reasonable procedures to assure maximum possible accuracy" of consumer reports. Spokeo operates a website that provides information about individuals drawn from public records and social-networking sites. Robins claimed Spokeo's website stated that he held a graduate degree and was wealthy, when he did not and was unemployed. A lower court dismissed the case for failure to plead an injury. The Ninth Circuit Court of Appeals, however, reversed that decision and held the Robbins had standing to sue Spokeo because "a plaintiff can suffer a violation of the statutory right without suffering actual damages."

The fact that the Supreme Court invited the U.S. Solicitor General to file a brief in the Spokeo case may indicate a leaning toward supporting the Ninth Circuit's decision in the case. That's because in the First American case, the Solicitor General supported allowing that class-action lawsuit to proceed without a showing of actual damages — a position the Ninth Circuit concurred with in that case as well. In addition, the recent decision of the Supreme Court in Jesinosky v. Countrywide Home Loans Inc. suggests that the high court favors strict TILA and RESPA regulatory compliance. The federal Eighth Circuit Court of Appeals upheld dismissal of the Jesinoski complaint without a trial on the grounds that the borrower forfeited relief by failing to begin litigation within three years of closing the loan. The Supreme Court overturned the Eighth Circuit, reinstated the complaint and sent the case back to the lower court.

The cases could ultimately have the effect of significantly lowering barriers to certifying class-action cases. Adding to the potential risk is the 2014 federal Eleventh Circuit Court of Appeals ruling in Darcel D. Fisher Harris vs. Harvey Schonbrun, Trustee, which also dealt with TILA and states that "the reasonableness of attorney's fees and costs is not limited by the dollar value of the underlying loan agreement." In essence, that means a plaintiff's attorney's fees charged to a lender can be many times greater than the actual dollar value of the original loan. That creates yet another incentive for plaintiff attorneys to pursue a class-action case for alleged TILA or other statutory violations.

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Mortgage originators cannot sit back and wait for the Supreme Court to decide these pending cases and risk the onset of a wave of class-action lawsuits filed by plaintiff lawyers. They must actively seek to comply with the broad intent of industry regulations through continual education and supervision of compliance practices, procedures and systems in RESPA, TILA and other regulatory matters. ■