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Race Discrimination Settlement

Justice Department Settles with Car Dealerships Regarding Alleged Discrimination under ECOA

The Justice Department has settled two cases alleging discrimination by automobile dealerships under the Equal Credit Opportunity Act ("ECOA"). The settlement may have favorable implications on fair lending issues in the mortgage industry. In the two separate complaints -- the first of their kind -- the Justice Department alleged that Pacifico Ford Inc. and Springfield Ford Inc. (the "Dealers") violated ECOA by charging systematically higher markups on car loan interest rates to African-American customers.

Specifically, the complaints alleged that for each loan application referred by the Dealers and subsequently accepted by a lender, the Dealers received a risk-related finance charge for a particular consumer after consideration of the consumer's credit risk and the terms of the deal (the "Buy Rate"). Subsequently, the Dealers added an Interest Rate Markup, a non-risk related finance charge, to the Buy Rate, which resulted in the Contract Rate that was disclosed to the consumer.

In a majority of deals from January 1999 through December 2002, the Dealers added as much as four percentage points to the Buy Rate. Moreover, in deals where the lenders allowed the Dealers to charge consumers the Buy Rate and an Interest Rate markup, the Dealers received an incentive paid by the lenders (a "Dealer Participation Incentive").

During this time, the Dealers allegedly charged African-American consumers higher Interest Rate Markups than similarly situated non-African-American consumers. The Justice Department found that the differences in the Interest Rate Markups between the automobile loans made to African-American consumers purchasing automobiles from the Dealers and those made to non-African-American consumers could not be fully explained by factors unrelated to race (e.g., differences in the consumers' creditworthiness or by differences in the down payment amounts provided by consumers). As such, the Justice Department found the differences statistically significant.

The settlement, among other things, prohibits the Dealers from charging a consumer a Dealer Reserve (the difference between the APR and the Buy Rate) more than 2 1/2 percentage points for loans with terms of less than 60 months. However, the Justice Department indicated that the Dealers may negotiate a Dealer Reserve lower than the pre-determined starting level for a good faith, competitive reason that is consistent with ECOA. A "good faith, competitive reason" is defined as a lower cap imposed by the lender for

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Massachusetts Attorney General Revises "UDAP" Regulations

The Massachusetts Attorney General defines unfair and deceptive trade practices through promulgation of regulations. On October 17, 2007, the Attorney General adopted new regulations, which take effect November 15, 2007, in an attempt to further illuminate what constitutes unfair and deceptive trade practices in Massachusetts. Note that the regulations make clear that the enumerated practices are not exclusive, and that even though a practice is absent from the regulations, it is not necessarily deemed legitimate. The regulations apply to any mortgage broker or lender advertising or doing business in Massachusetts. Additionally, the regulations apply to all residential mortgage loan transactions in Massachusetts except reverse mortgage, open-end lines of credit and reduced interest rate mortgages administered by state, quasi-public or local government entities.

The first practices addressed by the new regulation are advertising practices. Among other prohibited practices, a broker or lender may not misrepresent the advertised mortgage loan's terms, conditions or charges, including (1) advertising "immediate approval" or "immediate closing," (2) advertising a "no point" mortgage loan when points are required or accepted by the lender, (3) advertising an incorrect number of required points, or (4) advertising containing the phrase "bad credit no problem" or similar phrases, without clearly disclosing the material limitations on the availability of credit.

A lender or broker also may not use the phrase "avoid foreclosure" or similar words without (1) disclosing that

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the particular transaction, a constraint on the customer's ability to satisfy monthly payment requirements, a statement by the customer that he or she has access to an equal or more favorable offer from another dealer or lender, a special promotional offer extended to all customers on the same terms, the fact that a particular transaction is eligible for a manufacturer's credit or "supported" interest rates, the fact that the transaction is eligible for the Dealer's employee incentive program, or documented inventory reduction considerations related to specific vehicles.

It remains to be seen the extent to which the Justice Department will continue to focus its attention on the lending practices of car dealerships. Nonetheless, the Justice Department's acknowledgment that pricing differentials may be valid if based on a good faith, competitive reason consistent with the ECOA may serve as welcome guidance beyond the car dealership industry.

Class Certification Denied in Recent Credit Card Truncation Claims

Two nearly identical rulings have recently emerged from the Central District of California wherein two federal district courts denied class certification for the plaintiffs' failure to meet the requirements of Rule 23(b). Both *Najarian v. Charlotte Russe, Inc.* and *Spikings v. CostPlus, Inc.* were brought pursuant to The Fair and Accurate Credit Transactions Act ("FACTA"), which prohibits "print[ing] more than the last five digits of the credit or debit card account number or the expiration date upon…[a]ny receipt provided to the cardholder." The named plaintiff in each case was a consumer who had made a purchase at the defendant's establishment and when they received a receipt for their purchase, their cards' last four digits and expiration dates appeared on their receipts in violation of FACTA. Plaintiffs contended that this conduct constituted a willful violation of FACTA and sought statutory damages of not less than $100 and not more than $1,000, as well as punitive damages and attorney's fees on behalf of a class of similarly situated consumers.

In following a long line of cases from other district courts which have found class treatment improper under similar circumstances because the "superiority" requirement of Rule 23(b) had not been met, the *Najarian* and *Spikings* courts outlined essentially four primary reasons for their denial of class certification. First, the courts noted that imposition of liability on these defendants would be vastly disproportionate to any harm suffered by the plaintiffs, especially in light of the fact that the potential damage award could greatly exceed the defendants' net worth. Second, the courts found that neither plaintiff had suffered any actual harm, such as identity theft, as a result of the defendants' conduct. Even if any of the consumers had suffered actual damage, denial of class certification would not preclude those customers from proceeding with individual cases. Third, while recognizing that defendants had technically violated FACTA, the courts highlighted the defendants' prompt action to remove the expiration date from the receipts upon becoming aware of the violation.

Finally, as other courts have found, the *Najarian* and *Spikings* courts stated that "a class action would not be the superior method for the fair and efficient adjudication of the controversy … because it could possibly open the potential for abuse by the attorneys." While not expressly commenting on the conduct of the plaintiffs' attorneys in these particular cases, the courts reiterated that attorney abuse was a legitimate concern, especially given the "enormous contrast between the huge liability suffered by the Defendant and the lack of harm suffered by the Plaintiff."

Court Rejects "Required Use" Claim Under Respa Section 9

A federal district court judge in South Carolina recently granted summary judgment in favor of a seller of real estate owned property on a claim brought under Section 9 of the Real Estate Settlement Procedures Act. In the case of *Hopkins v. Horizon Management Services, Inc.,* the plaintiff-buyer alleged that she had been required to purchase, as a condition to the sale of the property, title insurance from a particular title company. Section 9 of RESPA provides that "[n]o seller of property that will be purchased with the assistance of a federally related mortgage loan shall require directly or indirectly, as a condition to selling the property, that title insurance covering the property be purchased by the buyer from any particular title company."

In July 2006, the buyer entered into a contract for the sale of certain property located in West Columbia, South Carolina. The seller was a servicer which had previously serviced a loan secured by a mortgage on the property and had acquired the property through a foreclosure sale. An addendum to the contract provided that the seller would pay the title examination fee and the premium for an owner's title insurance policy, while the buyer would pay the customary closing fee to the closing agent. The addendum also provided that, if the buyer obtained a mortgage loan in connection with the purchase, she would pay any premium for her lender's title policy. Notably, the addendum did not specifically require her to purchase the lender's policy from a particular title company. Finally, the addendum allowed the seller to select the closing agent.

A third-party vendor with a service agreement with the seller arranged for the processing of title and closing work for the sale. The vendor selected a closing agent, who was instructed to issue a title commitment and policy on behalf of the vendor's affiliated title company. Prior to this, however, the buyer had contacted a mortgage broker to arrange for the financing for her purchase. The mortgage broker advised the buyer that she should select a lawyer for the closing. After the buyer selected a law firm from a list supplied by the broker, the broker sent a title order to that firm, which then began preparing the title work.

Subsequently, the third-party vendor informed the buyer's mortgage broker that the buyer was required to use the closing agent it had selected. The buyer seemingly acceded, and later conceded that she did not request to have a lawyer from the firm she selected represent her in the transaction and, further, that she never informed anyone that she wanted to purchase a lender's title policy from her chosen firm. At closing, the seller purchased the owner's title policy for $270, and the buyer purchased the lender's policy for $75 and paid a settlement fee of $300. Also at closing, the buyer received disclosures indicating that she had the legal right to choose her own title insurer.

A putative class action lawsuit followed. On the seller's motion for summary judgment, the district court held that the buyer had not been required to purchase

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the borrower must refinance the mortgage in default and/or purchase a new mortgage loan, (2) informing the borrower that he may be required to pay higher interest rates, and (3) warning the borrower that "you may lose your home if you cannot make all the payments or if you miss any of the payments on this loan."

Additionally, the new regulations provide eighteen paragraphs of prohibited practices, including, but not limited to:

Lenders and brokers may not make any representation or statement of fact that is false or misleading, or has a tendency to be false or misleading. Moreover, it is an unfair and deceptive trade practice to make any representation or statement of fact if the broker or lender does not have sufficient information upon which a reasonable belief in the truth of the representation or statement could be based.

Lenders and brokers may not charge an application or broker fee that significantly deviates from industry-wide standards or is otherwise unconscionable.

Lenders and brokers may not accept any broker fee, application fee or other fee prior to the borrower's receipt of the Disclosure Forms. The exception to this rule is that a broker or lender may accept an appraisal fee after notice as to the refund of said fee.

Lenders and brokers may not procure or negotiate a mortgage loan with rates or other terms that significantly deviate from industry-wide standards or that are otherwise unconscionable.

Lenders may not also act as mortgage brokers directly or indirectly in the same mortgage loan transaction.

Lenders may not charge a prepayment fee that violates Massachusetts law, significantly deviates from industry-wide standards, or is otherwise unconscionable.

Lenders and brokers may not accept any fees that were not disclosed.

Lenders and brokers may not make or arrange a mortgage loan unless the broker or lender, based on information known at the time the loan is made, reasonably believes at the time the loan is expected to be made that the borrower will be able to repay the loan based on the borrower's income, assets, obligations, employment status, credit history, and financial resources.

Lenders and brokers may not process a mortgage loan without documentation to verify the borrower's income ("no doc," "stated income" or "limited documentation" loan) unless the lender or broker provides a written document to the borrower before the closing that (1) identifies the borrower's income and source of income and (2) provides detailed information that, by applying for a mortgage loan on a no- or limited documentation basis, the consumer will pay a higher interest rate or increase charges, or have less favorable terms.

Brokers may not process or arrange a loan that is not in the borrower's interest. When broker's financial interest conflicts with borrower's interests, brokers must disclose the conflict and may not proceed to process, make or arrange the loan so long as the conflict exists. This duty may not be disclaimed.

Lenders may not use a pricing model for its mortgage loans which treats borrowers with similar credit criteria and bona fide qualification criteria different. Similary, lenders may not make a loan when any or all of the cost features of the mortgage loan are based on criteria other than the borrower's credit and other bona fide qualification criteria.

The new regulations also require that a borrower be provided with two new disclosure forms. The Mortgage Broker Disclosure Form must be provided to borrowers by brokers. The Mortgage Lender Disclosure Form (collectively, the "Forms") must be provided to borrowers by lenders. The Forms must also strictly conform to the samples provided in the regulations. Lenders and brokers must provide or mail the Forms to borrowers no later than three business days after the earliest of (1) the acceptance by the broker/lender of an oral or written loan application, (2) any communication which leads the broker/lender to incur any expenses (other than a credit report) on behalf of the borrower, (3) any oral or written agreement between the broker/lender and the borrower, or (4) the lender's issuance of a commitment. The new regulations also make it an unfair and deceptive trade practice to conceal or fail to disclose any fact relating to the transaction that may have influenced the borrower not to enter into the transaction. The effective date for provision of the Forms is January 2, 2008.

the owner's policy as a condition to the sale of the property. The court pointed out that the seller, not the buyer, had paid for the owner's policy. Furthermore, the court concluded that she did not "indirectly" pay for the title policy through: (a) the cash she brought to close (the seller's closing costs were deducted from the proceeds it otherwise would have received); (b) an increase in the property's price (there was no evidence to support the existence of such an increase); or (c) the settlement fee (which did not relate to the provision of title insurance, but related to other costs of closing).

The district court also held that the buyer had not been required to purchase the lender's policy as a condition to the sale of the property. The court found that, although the contract addendum did not specifically advise the buyer that she was free to use another title company, it did not require her to use a particular title company to purchase the lender's policy. The buyer argued that her lender would not have accepted a policy issued by a title company different from the seller's title company. The court found it irrelevant that a lender's requirement might limit her choice of title companies because it was not a requirement imposed by the seller. Next, the court rejected the buyer's argument that the vendor's instructions to the closing agent to issue the policy on behalf of the vendor's affiliated title company constituted a required use. The instructions were issued before the property was marketed for sale; the fact that the title work was ordered prior to marketing the property did not require the ultimate buyer to use a particular title company for the lender's policy. Finally, the court rejected the buyer's argument that she would have had to pay "several hundred dollars" more for a lender's policy had she obtained it from a title company other than the one issuing the owner's policy. To that, the court observed that an economic incentive to purchase title insurance from a particular title company is not the same thing as a direct or indirect requirement to purchase title insurance from that company.

Accordingly, the district court granted summary judgment in favor of the seller, and found moot the question of whether a class of similarly situated buyers could be certified. The buyer has since filed an appeal in the United States Circuit Court of Appeals for the Fourth Circuit.

States Licensing Update

ARKANSAS – Implements Record Retention Requirements

Effective October 1, 2007, all Mortgage Banker, Broker and Servicer Licensees are required to retain all records necessary to demonstrate compliance with the Fair Mortgage Lending Act for at least 5 years. Records kept on the licensee's premises must be available for immediate inspection by the Commissioner. If a licensee's records are maintained at an off-site location, such records must be available for inspection within 72 hours of notice to the licensee. A licensee must notify the Commissioner of any change to the location of its records within 30 days of such change. The new record retention requirements list certain documents that must be maintained by licensees and also confirm that licensees may maintain records electronically.

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