

WBSK MORTGAGE FINANCE NEWSLETTER

A PUBLICATION OF WEINER BRODSKY SIDMAN KIDER PC

Federal Deposit Insurance Act Preempts State Usury Claims

Maryland Court Affirms That Federal Deposit Insurance Act Pre-empts State Usury Claims Against Federally Insured State Banks

Just one day after the United States Circuit Court of Appeals for the Fourth Circuit issued an opinion holding that the National Banking Act ("NBA"), 12 U.S.C. § 21 et seq., preempts Maryland laws requiring that State's Commissioner of Financial Regulation to exercise certain powers over operating subsidiaries of a national bank, the United States District Court for the District of Maryland ruled that a provision of the Federal Deposit Insurance Act ("FDIA"), 12 U.S.C. § 1811 et seq., completely preempts state usury claims against federally insured state banks.

In the Maryland federal district court case, *White v. Irwin Union Bank and Trust Company*, a group of plaintiff borrowers alleged that the defendant -- a federally insured state bank -- violated multiple Maryland laws regulating mortgage lending by, among other things, imposing, charging, collecting and receiving excessive or illegal charges, costs and fees, including prepayment fees, late charges and origination fees. The lawsuit was commenced in Maryland state court and the bank removed the case to federal court. The borrowers subsequently moved to remand the case and amended their complaint to only assert state law claims based on the bank's collection of prepayment fees. The bank opposed the remand, arguing that because Section 27 of the FDIA completely preempts the state usury claims asserted by the borrowers, the federal court was properly vested with jurisdiction to hear the case.

In a letter opinion dated August 11, 2006, the federal district court

Continued on page 2

FTC Issues Guidance Re: EBR & Lead Generation

In a July 19, 2006 Informal Advisory Opinion (the "Opinion"), staff with the Federal Trade Commission ("FTC") indicated that although a lender does not have an established business relationship with a consumer who responds to a lead generator's solicitation, the FTC staff would not recommend a Do Not Call enforcement action against a lender that calls consumers who have responded to a lead generator's solicitation, if the lead generator provides adequate prior disclosure of certain material facts about the consequences of responding to such solicitations.

Under the Telemarketing Sales Rule, a person or entity is prohibited from calling a consumer whose number is on the National Do Not Call Registry, subject to certain limited exceptions. One such exception is for a person or entity that has an established business relationship ("EBR") with a consumer. While the lead generation process can create an EBR between the lead generator and the consumer, the EBR cannot be transferred to the lead purchaser.

The Opinion responds to a specific lead generation scenario whereby consumers visit a web site that offers to arrange for several lenders to compete for the consumer's business. ■



Seventh Circuit Rejects Class Action Settlement

In a recent decision, *Synfuel Tech., Inc. v. DHL Express, Inc.*, (7th Cir. 2006), the Seventh Circuit rejected a proposed class settlement, and remanded the case to the district court for further fairness analysis.

In 2002, Synfuel Technologies, Inc. filed suit against Airborne Express, Inc., claiming that Airborne's default rate policy violated federal common law. If a shipper failed to indicate an Express Letter's actual weight or write a "1" in the weight section, Airborne automatically charged a default five pound weight. The average cost difference was about five dollars. The district court refused to dismiss the case, and found that the policy resembled a penalty provision. The parties immediately entered settlement negotiations.

The proposed settlement allowed each class member to submit a proof of claim form and supporting documentation and receive up to four pre-paid Letter Express packages (valued at \$13), or up to \$30 in cash. The number of pre-paid packages or cash was proportionate to the number of instances of overcharge, with a cap of 12 instances for the pre-paid package option and 20 instances for the cash option. The district court held a fairness hearing, and found that the settlement was "generous in light of the fact that Plaintiff's case is subject to a number of strong defenses."

Quoting Federal Rule of Civil Procedure 23(e)(1)(C), the Seventh Circuit wrote that, "[a] district court may approve a settlement only if it is 'fair, reasonable, and adequate.'" It compared the district court's role to that of a fiduciary, and insisted that the district court "exercise the highest degree of vigilance in scrutinizing proposed settlements of class actions." The court listed a number of fairness factors, including: (1) the

Federal Deposit Insurance Act, Continued from page 1

agreed that the borrowers' claims were completely preempted and, therefore, denied the motion to remand. The court found that the language of FDIA Section 27 – which generally provides that state banks may, notwithstanding any state constitution or statute, take, receive, reserve, and charge interest at the rate allowed by the laws of the state where the bank is located – should be construed in the same way courts have interpreted Section 85 of the NBA, because the two contain similar language. The court cited the United States Supreme Court's 2003 opinion in *Beneficial National Bank v. Anderson*, which held that NBA Section 85 completely preempts state usury laws against national banks. The court further observed that because prepayment fees had been treated as "interest" under NBA Section 85, they should also be treated as "interest" under FDIA Section 27.

The decision by District Judge J. Frederick Motz in *White v. Irwin Union Bank and Trust Company* follows similar rulings reached in an earlier Maryland federal district court case, *Discover Bank v. Vaden*, and in an appeal to the United States Circuit Court of Appeals for the Third Circuit, *In re Community Bank of Northern Virginia*.

strength of plaintiffs' case compared to the amount of defendants' settlement offer, (2) the likely complexity, length and expense of the litigation, (3) competent counsel's opinion, and; (4) the stage of the proceedings and the amount of discovery completed at the time of settlement.

The court also provided a roadmap for conducting a fairness inquiry. The Seventh Circuit stated that the district court should quantify the net expected value of continued litigation to the class. To calculate this value, the district court should estimate the range of probable outcomes, and the probability of those outcomes. Parties should present evidence enabling outcome estimation, allowing the court to arrive at a "ballpark valuation."

The Seventh Circuit found that the district court never attempted to quantify plaintiff's case, or the value of the settlement offer to the class members. The district court accepted counsel's contention that the \$30 cap reflected Airborne's statute of limitations and voluntary payment

defenses, which the Seventh Circuit concluded was largely unsupported. Moreover, the court noted that the only attempt at definite valuation was made by an objector, and the district court rejected this valuation as "irrelevant to its evaluation of the fairness of the settlement."

The Seventh Circuit also expressed dissatisfaction with the proposed provision of pre-paid Letter Express envelopes. While the court found that the case was not covered by the Class Action Fairness Act (CAFA) of 2005, it noted that Congress requires heightened judicial scrutiny of coupon-based settlements, where counsel is awarded large fees and class members are left with coupons or other awards of "little or no value." The court distinguished the envelopes from coupons on the basis that they are a whole product, not just a discount on a future sale. However, the court expressed uneasiness at the requirement of forced future business and the unlikelihood that the full amount of Airborne's gains would be disgorged. ■

Massachusetts Adopts Emergency Rule Prohibiting Additional Acts for Lenders and Brokers

Massachusetts adopted an emergency rule effective September 8, 2006 that prohibits several additional acts for lenders and brokers.

Both brokers and lenders are prohibited from violating the disclosure requirements and loan limitations, as well as the prohibited practices provisions set forth in the Massachusetts regulations for high cost home mortgages. Additionally, a lender may not make or purchase such a loan originated by a broker. The rule also prohibits brokers and lenders from engaging in specific deceptive or coercive acts, or to engage in a pattern or practice of failing to make required disclosures. Finally, the rule requires two different advertisement disclosures for brokers and lenders: (1) the type and identification number of the entity's license, and (2) if a broker or lender directs an employee's or an associate's actions, the entity's name and license identification number must be disclosed in the advertisement.

With certain exceptions, the rule also prohibits brokers from issuing a mortgage loan lock commitment for itself or a lender, or to imply that a consumer can lock a rate with the broker. The new rule creates an additional broker advertisement disclosure requirement, that a broker cannot advertise any interest rate or loan without stating, "We arrange but do not make loans." Finally, the emergency rule requires brokers to provide the loan origination and compensation agreement to the consumer at the time of application.

Changes to the Georgia Regulations

On September 11, 2006, Georgia Department of Banking and Finance ("DBF") rule changes became effective. The DBF updated its advertising requirements to include electronic media advertisements. A licensee must now include the license name, license number, an office address and the words "Georgia Residential Mortgage Licensee" in any electronic advertisement or solicitation. The new rules also specify that loan files must have a copy of the order for an appraisal and final appraisal if the licensee ordered the appraisal. The revised regulations also contain an expanded definition of hiring a felon to cover retention of a felon, and require background checks to be filed within ten business days of the employee's hire date. Finally, the regulations now require licensed brokers that obtain their licenses between April 1 and December 31 to complete 12 hours of continuing education in order to qualify to renew their licenses for the next license renewal period.

On July 1, 2006, Georgia amended the Georgia Residential Mortgage Act to include an exemption for a natural person who is under an exclusive written independent contractor agreement with a subsidiary of a financial, bank, savings bank or thrift holding company, subject to an undertaking of accountability.

California Senate Bill 1609

California Senate Bill 1609, effective January 1, 2007, makes four changes that affect reverse mortgages in that state. The bill: (1) adds a language translation requirement in certain circumstances, (2) prohibits tying an annuity to a reverse mortgage or soliciting annuities to reverse mortgage borrowers during the rescission period after closing, (3) requires that counseling be provided by a HUD approved counselor in connection with any reverse mortgage transaction, and (4) changes a disclosure requirement for reverse mortgages.

With respect to the language translation requirement, if a lender negotiates primarily in Spanish, Chinese, Tagalog, Vietnamese or Korean ("Other Language"), a translation of the contract must be provided in the language in which it was negotiated, unless certain disclosures are provided to the applicant in the Other Language, or a translator assists the applicant in the negotiation of the loan. In this regard, if certain disclosures are translated and provided to the consumer, or the consumer has his or her own interpreter, then the requirement to provide a translation of the loan contract does not apply.

The translated contract is in addition to, not in substitution of, an English language contract or agreement. Moreover, the terms of the English language contract determine the rights and obligations of the parties, though the translation may be entered into evidence to show substantial difference between the material terms and conditions of the contract and the translation. If certain elements of the executed English-language contract lack an accepted non-English translation, the law allows for use of the English words.

The contract, if translated, must include a translation of every term and condition in the contract, but does not need to include any subsequent documents contemplated by the original document. Lenders and originators must provide the consumer with a notice at closing in the Other Language, to the effect that the law requires the provision of a translated contract or disclosure in the Other Language. ■

WBSK

MORTGAGE FINANCE NEWSLETTER

Weiner Brodsky Sidman Kider PC
1300 19th Street, N.W., Fifth Floor
Washington, D.C. 20036-1609

Weiner Brodsky Sidman Kider PC

(202) 628-2000
www.wbsk.com
info@wbsk.com

WBSK Newsletter is a publication of the law firm of Weiner Brodsky Sidman Kider PC. This Newsletter is intended to provide a concise and timely review of judicial developments, federal and state legislative, regulatory and other legal matters affecting the mortgage finance industry. It is not intended to be relied upon as a substitute for legal advice. © Copyright 2006 by Weiner Brodsky Sidman Kider PC. All rights reserved.

Bruce E. Alexander
Richard J. Andreano, Jr.
James A. Brodsky
Donald C. Brown, Jr.
Jo A. DeRoche
Troy W. Garris
Cynthia L. Gilman
Don J. Halpern
Gina A. Haschke
Nancy W. Hunt
Heather Cain Hutchings
Fedor Kamensky
Mitchel H. Kider
Thomas Lawrence III
Aldys A. London
James M. Milano
Tobias P. Moon
Rose-Michele Nardi
Brian P. Perryman
Haydn J. Richards, Jr.
Emily M. Rugg
Leah Schmutwitz Gellan
Ron G. Schonberger
Ann B. Shearer
Mark H. Sidman
John D. Socknat
David M. Souders
Cynthia G. Swann
Kristin D. Thompson
Sandra B. Vipond
Harvey E. Weiner
Natasha M. Williams
Government Relations Specialist
Andrew E. Zirnkeklis, Compliance Specialist
James C. Clarke, Jr., Licensing Specialist
Emanuel P. Cruz, Licensing Specialist
Melissa M. Jewett, Licensing Specialist