

# WBSK

## MORTGAGE FINANCE NEWSLETTER

A PUBLICATION OF WEINER BRODSKY SIDMAN KIDER PC

### A Fee “Undivided” Cannot Stand - 2nd Circuit Says No Services Equals a Fee Split

On August 6, 2007, the U.S. Circuit Court of Appeal for the Second Circuit overturned a district court ruling dismissing a consumer's complaint for failure to state a claim that an undivided unearned fee violated RESPA section 8(b). In *Cohen v. JP Morgan Chase*, the court stated that the applicability of RESPA section 8(b) to “undivided, unearned fees” is ambiguous. The court, however, stated that HUD's Statement of Policy 2001-1 resolves this ambiguity, and that such Statement must be accorded *Chevron* deference on the issue.

The lender provided the borrowers with a closing statement that listed a \$225 “post closing” fee. The borrower alleged that the lender provided no services for this fee. The lender disputed this claim, but for purposes of reviewing a judgment of dismissal, the court stated it must assume the borrower's allegations as true.

RESPA section 8(b) provides that: “No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a

federally related mortgage loan other than for services actually performed.” In a 2001 Statement of Policy (SOP 2001-1), HUD reiterated its longstanding position that it may be a violation of RESPA section 8(b) “... for one settlement service provider to charge the consumer a fee where no, nominal, or duplicative work is done, or the fee is in excess of the reasonable value of goods or facilities provided or the services actually performed.”

The borrower argued that these provisions prevent one service provider, such as a lender, from charging con-

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### RESPA: Courts Reach Different Conclusions on Meaning of Treble Damages Provision

You undoubtedly know that Section 8 of the Real Estate Settlement Procedures Act contains general prohibitions against kickbacks and fee-splitting. You also likely know that the remedies to plaintiffs for violations of Section 8 include treble damages, or as the statute states “three times the amount of any charge paid for such settlement service.” A recurring question, however, is what number gets trebled in treble damages cases.

Plaintiffs typically argue that RESPA entitles them to three times the total amount paid to the settlement service provider. Defendants typically argue that the allowable remedy is only three times the amount deemed to be unlawful. Two courts recently came down on different sides of the issue.

#### FOR PLAINTIFFS

The U.S. District Court for the Eastern

District of Pennsylvania recently sided with plaintiffs. In a putative class action case, *Yates v. All American Abstract Company, et al.*, the plaintiff alleged that the defendants illegally marked up fees for title and closing services when she refinanced her mortgage loan. The plaintiff sought treble damages under RESPA. On plaintiff's motion to dismiss, the court held that damages under RESPA are calculated as three times the

full amount charged by defendants. Acknowledging a split in authority on this issue, the court expressly rejected defendant's argument that treble damages were limited to three times the amount of any illegal mark up. This holding follows the similar conclusion by the court in 2006 in *Kahrer v. Ameriquest Mortgage Co.* and contrasts with the 1997 holding in *Morales v. Attorneys' Title Insurance Fund, Inc.* out of the Southern District of Florida.

#### FOR DEFENDANTS

The U.S. District Court of the Northern District of Ohio recently reached a different conclusion in *Carter v. Welles-Bowen Realty, Inc.* The plain-

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### **ARKANSAS – Passes Regulations on Continuing Education Requirements**

Effective June 15, 2007, Loan Officers are required to complete 8 hours of approved continuing education annually, of which at least 1 hour must be in mortgage industry ethics. Loan Officers must complete these requirements by December 31st of each year. These requirements apply only to Loan Officers who have held a Loan Officer License for a period of 180 days, consecutive or not, during the year for which continuing education is required.

### **CONNECTICUT – Authorizes National Licensing System and Amends Various Licensure Requirements**

Effective September 30, 2008, the Department of Banking is authorized to participate in the national mortgage licensing system and to require fingerprint cards from and conduct criminal history record checks on licensees and their officers and directors. Also effective September 30, 2008, Mortgage Originators will be required to obtain licenses rather than registrations, and licenses will expire annually on December 31st.

### **LOUISIANA – Passes Several Amendments to the Residential Mortgage Lending Act and Consumer Credit Law**

Effective June 18, 2007, the Office of Financial Institutions is authorized to implement and/or participate in the national mortgage licensing system. Effective August 15, 2007, the Residential Mortgage Lending Act will require that all professional education courses include at least 30 minutes of instruction regarding changes or updates in the residential mortgage lending business, as well as changes to the licensure and examination processes in Louisiana.

### **MASSACHUSETTS – Finalizes Regulatory Bulletin Regarding Experience Requirements**

The Division of Banks finalized its revisions to Regulatory Bulletin 5.1-102, detailing new experience

requirements for Mortgage Lender and Mortgage Broker Licensing. Under the new requirements, Mortgage Broker License applicants are required to demonstrate at least 3 years of full-time experience working for a licensed mortgage broker, mortgage lender or exempt entity in order to qualify for licensure. Mortgage Lender License applicants must demonstrate at least 5 years of such experience in order to qualify for licensure. Individuals who will serve as Branch Managers for Mortgage Broker or Mortgage Lender Licensees must demonstrate at least 3 years of such experience in order to serve in such capacity.

### **OREGON – Amends Consumer Finance Act Requirements**

In addition to consumer finance loans, effective July 1, 2007, amendments to the Oregon Consumer Finance Act clarify that a Consumer Finance License is required in order to make payday loans and title loans in amounts of \$50,000 or less.

### **RHODE ISLAND – Adopts Loan Originator Licensure Requirements and Increases Surety Bond Requirements**

Rhode Island has established registration and licensure requirements for Loan Originators. All Loan Originators will be required to register with the Rhode Island Department of Business Regulation by March 31, 2008. The registrations will only be effective until January 1, 2009, at which time, Loan Originators will be required to obtain licenses. Loan Originator License applicants will be required to demonstrate the completion of 24 hours of pre-licensure education within the 2 years prior to application. Applicants employed as loan originators for 5 or more years as of January 1, 2009 will only be required to demonstrate the completion of 12 hours of education. Additionally, Loan Originator Licensees will be required to complete 8 hours of approved continuing education annually.

Effective March 31, 2007, the required surety bond amounts for Loan Broker and Lender applicants is in-

creased to \$20,000 and \$50,000 respectively. In addition, effective January 31, 2008, the Department of Business Regulation is authorized to participate in the national mortgage licensing system and to require fingerprint cards from and conduct criminal history record checks on licensees and their officers and directors.

### **TEXAS – Amends Various Mortgage Broker and Loan Officer Licensure Requirements**

Effective September 1, 2007, the Mortgage Broker License Act (“MBLA”) is expanded to govern mortgage brokers and loan officers making subordinate lien mortgage loans. Mortgage Brokers licensed under the MBLA will no longer be required to obtain a Regulated Loan License in order to make or broker subordinate-lien loans with effective interest rates that exceed 10%.

Effective January 1, 2008, Corporations, Limited Liability Companies (“LLC”), and Limited Liability Partnerships (“LLP”) will be required to obtain a Mortgage Broker License in order to engage in licensable activity under the MBLA. Entities applying for licensure will be required to designate an individual Mortgage Broker Licensee as its “designated representative.” For corporations, the designated representative must be an officer. For LLC’s, the designated representative must be a manager. For LLP’s the designated representative must be an individual general partner, an officer of a corporate general partner, or a manager of a general partner that is an LLC.

Individual Mortgage Broker applicants will be required to complete 90 hours of education prior to licensure if the applicant has not previously been licensed as a Texas Mortgage Broker or Loan Officer. Applicants that have previously been licensed as a Loan Officer, but not a Mortgage Broker, will be required to complete 30 hours of education prior to licensure.

The amendment also establishes a provisional loan officer licensing scheme for those applicants having at least 18 months of experience as a loan officer during the 20 months preceding the filing of their application, but who otherwise lacking the experience and educational requirements for licensure. Provisional loan officer licenses will be valid for 90 days.

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sumers a fee for which no work is performed. In the prior matter of *Kruse v. Wells Fargo*, decided by the 2nd Circuit in 2004, the court addressed related, but distinct issues, and held that SOP 2001-1 clearly disallowed lender mark-ups of third party fees, but that such Statement could not impose price controls on lenders by limiting the fees lenders charge for their own services to “reasonable” amounts. *Cohen* addresses a third question – may a lender permissibly assess a fee where no services are performed, or so-called “undivided, unearned fees.”

The court reviewed the statutory language of RESPA section 8(b), and found that it was not clear. The court then noted that when legislative intent is not clear, pursuant to principles enunciated by the U.S. Supreme Court in *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, courts will defer to an agency’s interpretation of a statute if the agency interpretation is reasonable. The court then stated that HUD acted pursuant to authority in issuing SOP 2001-1 and that it reasonably interprets RESPA section 8(b) to prohibit unearned fees whether such fees are reflected in a charge divided among multiple parties or an undivided charge from a single lender. In interpreting the phrase “any portion, split or percentage of any charge” the court noted that the clause can be construed to prohibit unearned fees regardless of whether or not they are divided. Based on the court reading of the statute, and HUD’s agency pronouncements, the court found that the borrower adequately stated a claim under RESPA section 8(b) by alleging the lender collected an undivided unearned fee. The Second Circuit’s decision in *Cohen* that a lender may violate RESPA by splitting a fee with itself is at odds with prior rulings of other federal Circuit Courts of Appeal.

The borrowers also made a claim under state law that the lender’s practices were misleading and thus violative of New York’s unfair and deceptive acts and practices (UDAP) laws. The district court dismissed this claim also, but the court overruled this dismissal noting that New York courts have held that collecting fees in violation of federal

law may satisfy the misleading element under New York's UDAP law.

The case was remanded to the district court for further proceedings where the lender undoubtedly will put on evidence of the services it performed in return for the post closing fee. ■

## No Private Right of Action Available under RESPA Section 8 Where Injury from Kickback Not Alleged

In the case of *Carter v. Welles-Bowen Realty Inc.*, decided by the U.S. District Court of the Northern District of Ohio on May 31, 2007, the court held that a private right of action does not exist under RESPA when a consumer does not show injury from an alleged kickback.

In *Carter* the homeowners brought suit against their real estate agent and a related title agency that performed settlement services. The homeowners alleged that the title agency did not perform any work and was a sham agency formed to allow the title company to provide illegal kickbacks to the real estate agency in exchange for the referral of settlement services. The court noted that RESPA section 8 requires consumers to prove actual damages. Because the homeowners in *Carter* did not allege that the title agency overcharged them for settlement services, the court found they had no damages and thus lacked standing to sue. ■

## Oregon Amends Consumer Finance Laws

On July 1, 2007, Oregon amended its consumer finance laws. The newly added provisions apply to Consumer Finance Loan lenders making loans of \$50,000 or less. A "consumer finance loan" is defined as a loan or line of credit that is unsecured or secured by personal or real property and that has periodic payments and

terms longer than 60 days. The new limits provide that the new maximum APR for a consumer finance loan is the greater of 36% or 30 percentage points in excess of the 90-day commercial paper in effect at the Federal Reserve Bank of San Francisco. The new provisions explicitly allow for: (1) fees that are exempted from the computation of the finance charge in accordance with TILA, (2) prepayment and late fees, (3) fees and damages in accordance with an action taken against the maker of a dishonored check, (4) actual expenses reasonably incurred in collecting a loan that the borrower has failed to repay according to the contractual terms, and (5) amounts associated with the collection of a defaulted loan authorized by statute or a court of law. Additionally, the new law strikes the provision that would allow a licensee to contract for and receive additional charges as agreed upon by the licensee and the borrower. ■

## Virginia Attorney General Opines On Prepayment Penalties

On June 1, 2007, the Virginia Attorney General (the "AG") issued an official advisory opinion regarding the Virginia law that prohibits lenders from assessing prepayment penalties when prepayment of a home loan results from a lender's enforcement of a due-on-sale clause contained in the loan contract. The question presented was whether the Virginia prepayment penalty law is preempted when a federally regulated financial institution purchases a mortgage from a state-regulated mortgage lender.

Virginia law provides, in part, that no lender may collect or receive any prepayment penalty on a certain home loan if the prepayment results from the enforcement of a due on sale clause. [Virginia law also prohibits lenders from assessing a prepayment penalty to a seller of a home securing the lender's loan when the lender refuses to approve the purchaser of

the home for an assumption of the seller's loan within 15 days of such request. This provision was not the subject of the request for an opinion in this matter.]

Rather than address the preemption issue, the AG concluded that, under the facts as described, a state-regulated lender could charge the prepayment penalty, and therefore, for purposes of Virginia law, the federally-regulated lender could lawfully do the same.

The AG opined that most real estate transactions contractually require a seller to convey clear and marketable title upon sale of their home. To do so, most sellers voluntarily pay off any liens on the property prior to sale. The AG found that in these instances the lender is not *enforcing* the due-on-sale clause, but rather the seller is *voluntarily* paying lender pursuant to his or her contractual obligations. The outcome of this analysis is that the prohibition against prepayment penalties is not triggered for *any* lender that does not actively enforce a due-on-sale clause, regardless of whether it is state- or federally-regulated. Thus, the AG concluded, no preemption issue presented itself, because both the state- and federally-regulated lender could legally charge the prepayment penalty under the facts as described in the request for the opinion. ■

## Culpepper IV - 11th Circuit Rules Again

For the fourth time, a federal court has reviewed the borrowers' allegations of RESPA violations in the matter of *Culpepper v. Irwin Mortgage Corporation*. This case began with borrower allegations that the lender's payments of yield spread premiums (YSP), to mortgage brokers in connection with the borrowers' home loan, and other borrowers similarly situated, was illegal under RESPA section 8.

The procedural backdrop of the *Culpepper* matter is cumbersome, but essential in understanding the Court's most recent ruling. In *Culpepper v. In-*

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## Court Holds Parity Act Preempts Maryland Law Regulating Balloon Loans

In a July 5, 2007 decision, the United States District Court for the District of Maryland held that the Alternative Mortgage Transactions Parity Act (“AMTPA”) preempted a provision of the Maryland Code regulating balloon loans. In *Cabrejas v. Accredited Home Lenders, Inc.*, the court found, in the circumstances alleged by the plaintiffs, that the loans: (a) were alternative mortgage transactions and (b) complied with the relevant Office of Thrift Supervision (“OTS”) regulations. As a result, certain claims brought under Maryland law were preempted.

*Cabrejas* was brought as a class action by borrowers who received subordinate-lien loans that included balloon payment features at the end of a 15-year period. The plaintiffs claimed, among other things, that the defendant lender violated Maryland Code § 12-404(c). Section 12-404(c) prohibits subordinate-lien loans that do not amortize in equal or substantially equal monthly installments, except in limited circumstances. The plaintiffs contended that the final balloon payments ran afoul of Section 12-404(c) because they constitute “unequal” payments under the statute. The defendant lender filed a partial motion to dismiss, arguing that the plaintiffs’ claims under Section 12-404(c) were preempted.

In its analysis, the District court relied upon Fourth Circuit case law on the AMTPA and its preemptive reach to loans by non-federally chartered housing creditors. Essentially, the AMTPA allows non-federally chartered housing creditors to make alternative mortgage transactions without regard to state law limitations thereon, including state law limitation on balloon payment features. State laws that would normally apply to a loan transaction

are preempted by the AMTPA if the loan: (1) qualifies as an “alternative mortgage transactions” under the statute and (2) conform to certain OTS regulations. In order to qualify for preemption under the AMTPA, both criteria must be satisfied.

The defendant lender argued in its motion to dismiss that both criteria were satisfied. In their opposition, plaintiffs did not dispute the first prong for preemption. Consequently, the court summarily concluded that the balloon loans at issue were “alternative mortgage transactions” under AMTPA. Instead, the plaintiffs’ opposition focused on 12 C.F.R. § 560.35, which requires adjustments to interest rates on a loan to “correspond directly to the movement of an index.” Plaintiffs contended that the defendant failed to comply with the OTS regulation because the loans were variable-rate loans that did not follow an index.

The court rejected the plaintiffs’ arguments, holding that their loans were not variable-rate loans. Rather, the court found that the adjustment of the payments – i.e. the balloon payments due at the end of each loan’ term – was simply a product of the fact that the plaintiffs’ loans would mature before their scheduled amortization. The court further noted that obtaining a new loan to make the balloon payment does not make the original loan “adjustable” within the meaning of 12 C.F.R. § 560.35. Rather, to the extent that the interest rate “changes” by virtue of the new loan, that change is not an adjustment to the interest rate of the original loan.

Finding no violation of the OTS regulation, the court held that Section 12-404(c) was preempted with respect to the loans.

*land Mortgage Corporation (Culpepper I)* decided in 1998, the U.S. Court of Appeal for the Eleventh Circuit reversed a grant of summary judgment in favor of the lender, vacated the district court's denial of class certification, and remanded for further proceedings. In *Culpepper v. Inland Mortgage Corporation (Culpepper II)*, also decided by the Eleventh Circuit in 1998, the court denied the lender's petition for a rehearing of *Culpepper I*, and clarified its decision in that case.

After the court's decision in *Culpepper II*, HUD issued Statement of Policy 1999-1 which provided, among other things, that YSPs are not *per se* illegal. In 2001, in *Culpepper v. Irwin Mortgage Corporation (Culpepper III)*, the Eleventh Circuit clarified the standard for liability under RESPA, and also affirmed the district court's class certification. In *Culpepper III*, in reviewing the question of class certification, the court agreed with the parties that it could only determine if class certification was appropriate if it first settled on a rule of liability under RESPA section 8. In *Culpepper III*, the court labeled the 1999 HUD Statement of Policy as "ambiguous." The court then held that it was not enough for a lender to show that services had been performed by the mortgage broker; rather, it stated that the lender must show that the services that were performed were directly

tied to the YSP payment.

In 2001 HUD issued Statement of Policy 2001-1 to reiterate its position that YSPs are not *per se* legal or illegal, and also to clarify the test for the legality of such payments set forth in HUD's 1999 Statement of Policy.

After the 2001 Statement of Policy, the defendant-lender in *Culpepper* filed motions for summary judgment and to decertify the class. Prior to deciding *Culpepper IV*, in 2002 the Eleventh Circuit ruled in *Heimmermann v. First Union Mortgage Corporation* that 2001 2001 Statement of Policy had explicitly rejected the foundation of *Culpepper III* and the court was bound to apply the revised two-step test as it had been articulated by HUD in the 2001 Statement of Policy.

In *Culpepper IV*, the court reiterated that HUD Statement of Policy 2001-1 constituted controlling authority carrying the force of law. The court also held that its prior holding in *Culpepper III* was "clearly erroneous," such that it "would work manifest injustice" if followed. The court echoed its earlier holdings in *Heimmermann* and other cases that in order to determine whether a yield spread premium payment violates RESPA, a court must first determine whether goods or facilities were actually furnished or services were actually performed, and if so, whether the total compensation paid to the broker is reasonable in light

of the goods, services or facilities actually provided or performed by the broker. Based on this two-part test, the court held that the lower court did not abuse its discretion in decertifying the class of plaintiffs in the case because individual issues of fact predominate in these types of RESPA actions. Additionally, the court held that the defendant-lender was entitled to summary judgment because the borrowers failed to satisfy their "burden of demonstrating, with specific evidence, that the total remuneration that their brokers received was unreasonable." Thus, apparently, ends the saga that was *Culpepper*. ■

## Illinois Predatory Lending Database Pilot Program Upheld

On May 24, 2007, in *Bell v. Martinez*, the U.S. District Court for the Northern District of Illinois upheld the Illinois Predatory Lending Database Pilot Program. After the Bell suit was filed in late 2006, the Pilot Program was suspended in January 2007 via re-designation of the Pilot Program areas to include no zip codes or areas. In March 2007, the Governor directed the Illinois Department of Financial and Professional Regulation (the "DFPR") to file new regulations to implement the Pilot Program. Regulations remain forthcoming. For more information on these developments and the Pilot Program, see the June 2006, December 2006 and April 2007 editions of the WBSK Mortgage Finance Newsletters.

The plaintiffs in *Bell* alleged that the Pilot Program violated constitutional principles of equal protection and due process and also resulted in unreasonable searches and seizures. The U.S. District court for the Northern District of Illinois, however, found that the plaintiffs' complaint failed to state a claim for equal protection, due process, and/or unreasonable search and seizure violations. ■

### Typographical Error on Notice of Right to Cancel Does Not Extend Rescission Period

In the bankruptcy case of *In re Groat*, the U.S. Bankruptcy Appellate Panel of the Eighth Circuit ruled that a lender that committed a typographical error by placing the wrong year on the notice of right to cancel was entitled to TILA's bona fide error defense because the error was unintentional, the lender had procedures in place to avoid such errors, and the error was obvious and not misleading. The borrower also argued that the rescission period was extended to three years because the lender did not sign the notice of right to cancel. The court observed that the TILA does not require a lender to sign the notice of right to cancel.

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tiffs purchased a home in Perrysburg, Ohio, and were represented in this transaction by Welles-Bowen Realty, Inc. WB Realty referred the purchasers to an affiliated title company to perform real estate settlement services incident to this purchase.

The Carters contended that the title company affiliate was a “sham” company that did not perform any settlement work but instead referred all title work to Chicago Title, a co-owner. The plaintiffs argued that the structure was a means to enable Chicago Title to provide illegal kickbacks to WB Realty in exchange for the referral of real estate settlement work in violation of Sections 8(a) and 8(b) of RESPA.

The defendants filed a Motion to Dismiss arguing that the treble damages provision provides for treble damages of the overcharge fee only, but the plaintiffs did not argue that they were overcharged for any settlement services so they lacked standing to bring the action.

In addressing the amount of damages permitted by Section 8(d)(2), the court followed the reasoning in *Morales* and the 2002 case *Moore v. Radian Group, Inc.* out of the Eastern District of Texas. The *Moore* court held: “Tying (and trebling) the recoverable damages to that portion of the charge for the settlement service ‘involved in the violation’ advances the purposes of RESPA while respect-

ing Article III’s command that a private plaintiff must suffer an actual injury before invoking the jurisdiction of a U.S. District Court.” The court also compared the damages provision to other damages provisions in RESPA, and considered the codified purpose of RESPA of protecting individuals ‘from unnecessarily high settlement charges.’ The court reasoned that allowing plaintiffs to recover where they conceded the charges were not unreasonable or excessive would not further this goal. Therefore, the court granted the defendants Motion to Dismiss finding that the plaintiffs lacked standing to bring the action because they did not allege any overcharge or other concrete injury. ■

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