Current Developments

in

Lender Liability Law

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Lender Liability Consumer Claims Part II

Racketeer Influenced and Corrupt Organizations Act (RICO), the Real Estate Settlement Procedures Act (RESPA) and the Fair Credit Reporting Act (FCRA)

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Overview of the Fair Credit Reporting Act

- The FCRA, has undergone two major revisions in its history:
  - The Consumer Credit Reporting Reform Act of 1996; and
  - The Fair and Accurate Credit Transactions Act of 2003 ("FACTA").

  * The stated purpose of the FCRA is to ensure fair and accurate credit reporting, because inaccurate reports directly impair the efficiency of the banking system, and unfair credit reporting methods undermine the public confidence which is essential to continued functioning of the banking system.

Consumer Reports

- The term “consumer report” means any written, oral, or other communication of any information **by a consumer reporting agency** bearing on a consumer’s credit worthiness, credit standing, credit capacity, character, general reputation, personal characteristics, or mode of living which is used or expected to be used or collected in whole or in party for the purpose of serving as a factor in establishing the consumer’s eligibility for:
  - Credit or insurance to be used primarily for **personal family, or household purposes (consumer);**
  - Employment purposes; or
  - Any other purpose authorized under the Act

Who Must Comply with the FCRA

The FCRA governs three distinct groups:

1. Credit Reporting Agencies ("CRAs");
2. Users of Information; and
3. Furnishers of Information.

* Lenders may be users or furnishers of information, depending on the specific circumstances of the transaction. The lenders role in any given transaction will determine which provisions of the FCRA govern its actions.

Users of Information

- Must have a permissible purpose for requesting the information. The only
- permissible purposes are listed in the Act:

- In response to a court order;
- A consumer's written instruction (permission);
- To a person it has reason to believe intends to use the information:
  - In connection with an extension of consumer credit, or review or collection of an account of, the consumer; or
  - For employment purposes;
  - In connection with the underwriting of insurance; or
  - In connection with a determination of a consumer's eligibility for a license or other government benefit;
  - As a potential investor or servicer, or current insurer, in connection with a valuation of, or assessment of the credit or prepayment risks associated with, an existing credit obligation; or
  - Otherwise has a legitimate business need for the information
    - In connection with a business transaction that is initiated by the consumer; or
    - To review an account or determine whether the consumer continues to meet the terms of the account.
  - In response to the head of a State or local child support enforcement agency; or
  - To an agency administering a State plan to set or modify child support obligations.

Users of Information

- Before taking any adverse action based in whole or in part on the report, the person intending to take such adverse action shall provide to the consumer:
  - A copy of the report; and
  - A description of the consumer's rights under the FCRA (must follow form prescribed under 15 U.S.C. 1681g(c)(3).

Furnishers of Information

- The responsibilities of furnishers of information to consumer reporting agencies is governed by 15 U.S.C. 1681s-2. However, there is no private right of action to enforce 1681s-2(a).
- 1681s-2(a) provides the duty of furnishers to provide accurate information
- These include:
  - Prohibition against furnishing a CRA information it knows or has reasonable cause to believe is inaccurate, or has been notified by the consumer contains inaccurate information and is in fact inaccurate;
  - Duty to correct and update information. This is typically done through E-OSCAR (e-Online Solution for Complete and Accurate Reporting);
  - Duty to provide the CRA with notice of a consumer's dispute;
  - Duty to provide notice of closed accounts;
  - Duty to provide notice of delinquency of accounts;
  - Duty to have reasonable procedures to respond to any notification of identify theft;
  - Duty to provide notice of furnishing negative information to a CRA, in writing, to the consumer within 30 days after furnishing the negative information;
  - A safe harbor for maintaining reasonable policies and procedures to comply with the FCRA;
  - A duty to reinvestigate a dispute concerning the accuracy of the information based on a direct request from a consumer (as compared to a dispute through a CRA)
  - A duty to conduct an investigation after receiving notice of a dispute within 30 days (may be extended another 15 days upon receipt of additional information from the consumer); and
  - Duty to provide notice to CRA if primary business purpose is providing medical services, product, or devices.

Furnishers of Information

- There is **no private right of action for inaccurate reporting** 15 U.S.C. § 1681s-2(1)(a); *see Caltabiano v. BSB Bank & Trust Co.*, 387 F. Supp. 2d 135, 140 (E.D.N.Y. 2005).
- A furnisher of information cannot be held liable in a civil suit merely for reporting bad information. Under the FCRA, furnishers of information can be held liable in a civil suit only for failing to conduct a reasonable reinvestigation with respect to the disputed information. *Id.* at 140-41.
- Accordingly, once a consumer disputes the debt with a credit reporting agency or the furnisher, the furnisher of information has a duty to investigate the dispute. 15 U.S.C. § 1681s-2(b)(1)(A). After the furnisher investigates the dispute, it also has a duty to promptly inform the credit reporting agencies ("CRAs") of the determination and provide corrected information, if necessary. See 15 U.S.C. § 1681s-2(a)(2). Promptly means within 30 days. The FCRA, 15 U.S.C. § 1681s-2(a)(3), further requires that if a consumer disputes the accuracy or completeness of any information that has been furnished to a CRA, the furnisher may not report this information to a CRA unless it notes that it is disputed.

Damages under the FCRA

- Sections 1681(o) and (n) of the FCRA impose liability only on a person who negligently or willfully fails to comply with the FCRA.
  - **1681(n)-** If the lender **willfully** fails to comply with any requirement of the Act, it is liable to the consumer in an amount equal to the sum of—
    - (1)(A) any actual damages sustained by the consumer as a result of the failure or damages of not less than $100 and not more than $1,000; (B) in the case of liability of a natural person for obtaining a consumer report under false pretenses or without permissible purpose, actual damages or $1,000, whichever is greater; or
    - (B) such amount of punitive damages as the court may allow; and
    - (C) in the case of any successful action to enforce any liability under this section, the costs of the action together with reasonable attorney's fees as determined by the court.
  - **1681(o)-** Any person who is **negligent** in failing to comply with any requirement under the Act is liable to the consumer in an amount equal to the sum of—
    - (1) any actual damages sustained by the consumer as a result or the failure; and
    - (2) in the case of any successful action to enforce any liability under this section, the costs of the action together with reasonable attorney's fees as determined by the court.
    - Lender may be awarded attorney's fees if the court finds that the consumer brought a claim in bad faith or for purposes of harassment.

Preemption Under the FCRA

Flood of Defamation Claims Coming?

- ***Earhart v. Countrywide Bank, FSB***, No. 3:08-cv-238 (W.D.N.C. 2/25/09).
- The court held that section 1681h of the FCRA may provide a private right of action for defamation. The court, however, confuses the duties of a user and a furnisher under the FCRA.
- The federal district courts are not in agreement on the issue, and the federal appellate courts have yet to clarify. Nonetheless, from the plain reading of the statute, sections 1681h(e) and 1681t(b)(1)(F) are not in conflict.
- Section 1681h(e) provides:
- Limitation of liability. Except as provided in sections 616 and 617 [§§ 1681n and 1681o] of this title, no consumer may bring any action or proceeding in the nature of defamation, invasion of privacy, or negligence with respect to the reporting of information against any consumer reporting agency, any user of information, or any person who furnishes information to a consumer reporting agency, **based on information disclosed pursuant to** section 609, 610, or 615 [§§ 1681g, 1681h, or 1681m] of this title or based on information **disclosed by a user** of a consumer report to or for a consumer **against whom the user** has taken adverse action, based in whole or in part on the report, except as to false information furnished with malice or willful intent to injure such consumer.
- Section 1681t((b)(1)(F) provides:
  - (b) General exceptions. No requirement or prohibition may be imposed under the laws of any State
    - (1) with respect to any subject matter regulated under
      - (F) section 623 [§ 1681s-2], relating to the responsibilities of **persons who furnish information** to consumer reporting agencies, except that this paragraph shall not apply . . .

The Racketeer Influenced and Corrupt Organizations Act ("RICO")

- RICO is a criminal statute that was originally intended to target organized crime.
- The statute creates a private right of action in favor of any person "injured in his business or property by reason of" a statutory violation. 18 U.S.C. sec. 1964(1).
- Use of civil RICO exploded in the 1980s and 1990s, principally for three reasons.
  - The statute provides for an award of treble damages and attorneys' fees to a successful plaintiff.
  - Congress mandated a "liberal" construction of the statute – "[t]he provisions of this Title should be liberally construed to effectuate its remedial purposes."
  - In several early cases interpreting RICO, the Supreme Court rejected attempts to limit RICO's scope to matters directly involving organized crime.

RICO Trends

- **Retrenchment:** Beginning in the late 1990s, however, RICO case law began to reflect a judicial attempt at retrenchment with respect to RICO's use in ordinary commercial litigation.
  - Rigorous pleading requirements, particularly Fed. R. Civ. P. 9.
  - Narrow interpretation of the "enterprise" and "pattern" elements.
  - Retrenchment has been severe in certain Circuits (Second, Seventh and Tenth), though far less so in others (Ninth and Eleventh).
- **Resurgence:** Has been a recent resurgence of RICO claims in commercial litigation, for several reasons.
  - Reaction to perceived abuses in the mortgage markets.
  - Broadening of the "enterprise" element in some Circuits (particularly, the Ninth).
  - Supreme Court's recent loosening of the reliance element for RICO claims based on underlying predicate acts of mail and wire fraud.

RICO's Substantive Prohibitions

- Section 1962(a): Prohibits the use or investment of any income received or derived from a **pattern of racketeering activity** to acquire, establish or operate an **enterprise**.
- Section 1962(b): Prohibits any person from acquiring or maintaining any interest in an **enterprise** through a **pattern of racketeering activity**.
- Section 1962(c): Prohibits any person employed by or associated with an **enterprise** from conducting or participating in the conduct of such enterprise's affairs through a **pattern of racketeering activity**.
- Section 1962(d): Prohibits a person from conspiring to violate any other provision of RICO.
- As the statutory language reflects, the concepts of "enterprise" and "pattern of racketeering activity" are critical to the RICO analysis.

The RICO Enterprise

- Section 1961(4) defines "enterprise" to include an individual, a legal entity and "any union or group of individuals associated in fact although not a legal entity."
- Association-in-Fact Enterprises
  - Prototypical example is an organized crime family – it has no formal legal existence, but exists in fact and has a distinct organization, structure and purpose.
  - *United States v. Turkette*, 452 U.S. 576 (1981): Defined an association-in-fact enterprise as "a group of persons associated together for a common purpose of engaging in a course of conduct," that must be alleged and established by "evidence of an ongoing organization, formal or informal, and by evidence that the various associates function as a continuing unit."

The RICO Enterprise (cont.)

- Courts have used the concepts of organization and continuity as a unit to restrict RICO's scope and to distinguish a RICO enterprise from a common law conspiracy by requiring that a plaintiff be able to provide the existence of the enterprise separate and apart from any pattern of racketeering. *Stachon v. United Consumers Club*, 299 F.3d 674 (7th Cir. 2000) ("This court has repeatedly stated that RICO plaintiffs cannot establish structure by defining the enterprise through what it supposedly does.").
- But in *Odom v. Microsoft Corp.*, 486 F.3d 541 (9th Cir. 2007), the Ninth Circuit took a contrary view, holding that "RICO does not require any particular organizational structure, separate or otherwise."
- In *Boyle v. United States*, the Supreme Court granted cert on the following question: "Does proof of an association-in-fact enterprise under the RICO statute . . . require at least some showing of ascertainable structure beyond that inherent in the pattern of racketeering activity in which it engages?" If the Court answers "no," we can expect the use of RICO to become even more prevalent in civil cases.

RICO – The Pattern of Racketeering Activity

- Statutory Definitions
  - Pattern: A pattern of racketeering activity requires at least two acts of racketeering activity" that occurred within ten years of each other. 18 U.S.C. sec. 1961(5).
  - Racketeering Activity: Defined to mean certain acts indictable under specific federal statutes and other enumerated acts chargeable under State law and punishable by imprisonment for more than one year. 18 U.S.C. sec. 1961(1).
    - In RICO parlance, individual acts of racketeering activity are referred to as "predicate acts."
    - Predicate acts include violations of the federal mail and wire fraud statutes. These statutes are very broad and form the basis of the vast majority of civil RICO claims, particularly those involving financial institutions.
  - Pleading Requirements
    - Section 1961(1) requires that the alleged predicate acts be "indictable," requiring that the complaint allege sufficient facts to establish probable cause.
    - Where the underlying predicate acts sound in fraud (such as claims based on mail and wire fraud), the plaintiff must satisfy the particularity requirements of Rule 9(b).
    - If a specific predicate act is not properly pleaded, it may not be considered for purposes of determining whether or not a pattern exists.

RICO – The Pattern of Racketeering Activity

- Focus on Long-Term, Continued Criminal Activity: In *H.J., Inc. v. Northwestern Bell Telephone Co.*, 492 U.S. 229 (1989), the Supreme Court recognized that the aim of RICO's pattern requirement is to differentiate run-of-the-mill, common law fraud from more serious conduct that portends a threat of continuing criminal activity.
  - Held that two predicate acts are necessary to establish a pattern under RICO, but typically will not be sufficient.
  - The Court imposed two additional pleading and proof requirements – the concepts of continuity and relatedness.
    - Continuity Requirement: The nature and duration of the predicate acts must demonstrate a threat of continuing criminal activity.
      - Can be "closed-ended" – a series of related predicate acts occurring over a substantial period of time.
      - Can also be "open-ended" – conduct that by its very nature threatens future criminal conduct, even if short-lived, such as where criminal acts are an entity's regular way of conducting business.
    - Relatedness Requirement: The predicate acts must be related in some meaningful fashion by having the same or similar purposes, results, participants, victims or methods of commission.

RICO – Mail and Wire Fraud as the Basis for a Pattern of Racketeering

- Most frequently alleged predicate acts because of the near universal use of the wires (email, internet, telephone, facsimile and wire transfers) in our electronic economy.
- This has resulted in some judicial reluctance to recognize patterns (particularly if the time period is reasonably short and/or the claimed pattern involves only a single scheme) based solely on predicate acts of mail and wire fraud.

RICO – Mail and Wire Fraud as the Basis for a Pattern of Racketeering (cont.)

- But the Supreme Court's decision in *Bridge v. Phoenix Bond & Indemnity Co.* has led to a marked increased in civil RICO claims based solely on mail and wire fraud.
  - The broad reading of *Bridge* (propounded by plaintiffs' class action lawyers) is that it eliminated any requirement of reliance on the alleged misrepresentations underlying the claimed acts of mail and wire fraud.
  - More appropriate reading is that the opinion clarifies that first-party reliance by the plaintiff is not required to establish a predicate act of mail or wire fraud and establish a pattern, but that RICO's proximate cause requirement still requires reliance by someone to show an injury "by reason of" a claimed RICO violation.
    - "Of course, none of this is to say that a RICO plaintiff who alleges injury 'by reason of' a pattern of mail fraud can prevail without showing that someone relied on the defendant's misrepresentations."
    - "In most cases, the plaintiff will not be able to establish even but-for causation if no one relied on the misrepresentation. . . . Accordingly, it may well be that a RICO plaintiff alleging injury by reason of a pattern of mail fraud must establish at least third-party reliance in order to prove causation."

Recent RICO Cases Against Lenders

- Several recent cases have been asserted against lenders arising out of the mortgage and subprime lending crisis
  - *In re Countrywide Financial Corp. Mortgage Marketing and Sales Practices Litigation*, -- F. Supp. 2d --, 2009 WL 458780 (S.D. Ca. Feb. 5, 2009).
  - *Meeks-Owens v. IndyMac Bank, F.S.B.*, 557 F. Supp. 2d 566 (M.D. Pa. 2008).
  - *Lester v. Percudani*, 556 F. Supp. 2d 473 (M.D. Pa. 2008).
- Relaxed reliance requirements after Bridge and the prevalent use of the mails and wires in financing and banking transactions portends an increased use of RICO claims against financial institutions in the mortgage and consumer- credit context.

Real Estate Settlement Procedures Act (RESPA) 12 U.S.C. § 2601, *et seq.*

- RESPA was enacted "to insure that [real estate] consumers...are provided with greater and more timely information on the nature and costs of the settlement process and are protected from unnecessarily high settlement charges caused by certain abusive practices." 12 U.S.C. § 2601(a).
- However, RESPA is not a price control statute. *See, e.g.*, *Kruse v. Wells Fargo Home Mortgage, Inc.*, 383 F.3d 49 (2d Cir. 2004) (discussing legislative history).

Prohibited conduct . . .Section 8 of RESPA

- 12 U.S.C. § 2607:
- **(a) Business referrals.** No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.
- **(b) Splitting charges.** 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.

- **Penalties and Damages For Violating Section 8**: Violations of Section 8 are subject to criminal and civil penalties. In a criminal case a person who violates Section 8 may be fined up to $10,000 and imprisoned up to one year. In a private civil suit, violators may be liable to the person charged for the settlement service in an amount equal to three times the amount of the charge paid for the service. Attorneys' fees are recoverable.

Conduct That Is Not Prohibited

- Employer's payment to its employees for any referral activities;
- Payments, including bona fide salaries and compensation, to any person for goods or facilities actually furnished or for services actually performed

Do the Fees Have to be "Split" to Violate Section 8 of RESPA?

- The Courts of Appeals for the **Second, Third** and **Eleventh** Circuits have held that the fees do not need to be split. *See Kruse v. Wells Fargo Home Mortgage, Inc.*, 383 F.3d 49 (2d Cir. 2004); *Santiago v. GMAC Mortgage Group, Inc.*, 417 F.3d 384 (3rd Cir. 2005); *Sosa v. Chase Manhattan Mortgage Corp.*, 348 F.3d 979 (11th Cir. 2003).
  - However, in *Friedman v. Market Street Mortg. Corp.*, 520 F.3d 1289 (11th Cir. 2008), the Eleventh Circuit went out of its way to question "whether the language in *Sosa* is controlling or is dicta," but did not decide the question.
- The Courts of Appeals for the **Fourth, Seventh** and **Eighth** Circuits have held that Section 8(b) cannot be violated unless the fee or charge has been improperly split or shared with a third party. *See, e.g., Haug v. Bank of Am.*, N.A., 317 F.3d 832 (8th Cir. 2002); *Krzalic v. Republic Title Co.*, 314 F.3d 875 (7th Cir. 2002); *Boulware v. Grassland Mortgage Corp.*, 291 F.3d 261 (4th Cir. 2002).

Markups and Overcharges

- **Markups**: A markup adds to charges by some third party (i.e., a vendor, Fed Ex, etc.).
- Some courts hold that markups, even if not split with a third party, are actionable. *See Kruse v. Wells Fargo Home Mortgage, Inc.*, 383 F.3d 49 (2d Cir. 2004); *Santiago v. GMAC Mortgage Group, Inc.*, 417 F.3d 384 (3rd Cir. 2005).
  - However, if any services were provided, such as arranging for a courier to pick up a Fed Ex package, then there may be no claim. *See id.; see also Sosa v. Chase Manhattan Mortgage Corp.*, 348 F.3d 979 (11th Cir. 2003); *Kingsberry v. Chicago Title Ins. Co.*, 586 F. Supp. 2d 1242 (W.D. Wash. 2008) (any services provided are sufficient).

Markups and Overcharges (cont.)

- **Overcharge**: An overcharge occurs when lenders perform services for borrowers, but charge substantially more than the services cost, or more than the provider is authorized under state law to charge.
- HUD and some plaintiffs have pushed courts to hold that an overcharge for services is actionable (i.e., a settlement service provider charging an unreasonable amount for a service or charging more than authorized under state law (for title insurance)).
  - Some courts expressly hold fees cannot be split into reasonable and unreasonable components. "[N]othing in th[e] language [of Section 8] authorizes courts to divide a 'charge' into what they or some other person or entity deems to be its 'reasonable' and 'unreasonable' components. Whatever its size, such a fee is 'for' the services rendered by the institution and received by the borrower." *Kruse v. Wells Fargo Home Mortgage, Inc.*, 383 F.3d 49, 56 (2d Cir. 2004). Because the language is clear and unambiguous, "[t]here is not enough play in the statutory joints to allow HUD to impose its own 'interpretation' under the aegis of *Chevron*." *Krzalic v. Republic Title Co.*, 314 F.3d 875, 881 (7th Cir. 2002).
  - Even exceeding a filed rate is not actionable as an overcharge. *See Hazewood v. Foundation Fin. Group, LLC,* 551 F.3d 1223 (11th Cir. 2008).
- If any service provided, no violation for an overcharge. *Busby v. JRHBW Realty, Inc.*, 513 F.3d 1314 (11th Cir. 2008).

What about Duplicative Fees?

- Courts are currently wrestling with the issue of whether there is a Section 8 violation if the allegation is that one of two or more charges is for goods, facilities, or services that are covered, at least in part, by another charge from that provider.
- Duplicative fees not actionable
  - *Cohen v. J.P. Morgan Chase & Co.*, 2009 WL 212159 (E.D.N.Y. Jan. 28, 2009): "A second fee charged for the same piece of work is an overcharge."
- Duplicative fees actionable
  - *Busby v. JRHBW Realty, Inc. d/b/a Realty South*, (N.D. Ala. April 20, 2009) (charge cannot be justified if separate services are not provided).

Affiliated Business Arrangements

- "An affiliated business arrangement" is not prohibited if it meets the statutory criteria, 12 U.S.C. § 2607(c)(4)
  - an affiliated business arrangement disclosure is made to each person whose business is referred;
  - person making referral does not require use of any particular provider of services (except lenders may require borrowers to pay for attorney, credit recording agency, or real estate appraiser chosen by lender);
  - only thing of value received from arrangement by person making referral, other than payments otherwise permitted by RESPA, is legitimate return on that individual's ownership interest in the affiliated business arrangement
- HUD has a ten point test to determine if the AfBA is a "sham."
- Very hot area for plaintiffs' counsel.

Affiliated Business Arrangements (continued)

- **Overcharge required:**
  Other courts have held that there is no standing to pursue a RESPA claim if the "injury" is not an overcharge for the services. *See, e.g.*, *Contawe v. Crescent Heights of America, Inc.*, 2004 WL 2244538, *3-4 (E.D. Pa. Oct. 1, 2004); *Mullinax v. Radian Guaranty, Inc.*, 311 F. Supp. 2d 474, 486 (M.D. N.C. 2004); *Moore v. Radian Group, Inc.*, 233 F. Supp. 2d 819, 825-26 (E.D. Tex. 2002); *Morales v. Attorneys' Title Ins. Fund, Inc.*, 983 F. Supp. 1418, 1427 (S.D. Fla. 1997); *Durr v. Intercounty Title Co. of Ill.*, 826 F. Supp. 259, 260-62 (N.D. Ill. 1993).

- **Overcharge not required:**
  Some courts have held that no "overcharge" need be proved when the claim involves a sham affiliated business arrangement. *See, e.g., Carter v. Welles-Bowen Realty, Inc.*, 553 F.3d 979 (6th Cir. 2009) (no overcharge is necessary when claim involves sham affiliated business arrangement); *Alexander v. Washington Mut., Inc.*, 2008 WL 2600323, at *6 (E.D. Pa. June 30, 2008); *Capell v. Pulte Mortgage L.L.C.*, 2007 WL 3342389, at *4-5 (E.D. Pa. Nov. 7, 2007); *Edwards v. First American Corp.*, 517 F. Supp. 2d 1199, 1204 (C.D. Cal. 2007); *Yates v. All American Abstract Co.*, 487 F. Supp. 2d 579, 582 (E.D. Pa. 2007); *Robinson v. Fountainhead Title Group Corp.*, 447 F. Supp. 2d 478, 488-89 (D. Md. 2006); *Kahrer v. Ameriquest Mortgage Co.*, 418 F. Supp. 2d 748, 756 (W.D. Pa. 2006); *Patton v. Triad Guar. Ins. Corp.*, No. CV100-132, at *5-6, 12 (S.D. Ga. Oct. 10, 2002); *Pedraza v. United Guar. Corp.*, 114 F.Supp.2d 1347 (S.D. Ga. 2000).

Relationship Between RESPA and Other Laws

- Increasingly plaintiffs are seeking to use allegations of RESPA violations to support other causes of action (expanding the statute of limitations period, etc.)
- Examples: state unfair and deceptive trade practices acts; fraud; RICO
- Expect to see many more RESPA cases given the microscope that is trained on mortgage lending transactions and new HUD regulations