

Residential Mortgage Issues in Consumer Bankruptcy Cases

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Introduction

The current subprime mortgage crisis demands new thinking by all participants in consumer bankruptcy cases. Debtors often are forced into bankruptcy by their inability to make their mortgage payments. Few consumer bankruptcy attorneys have the background or experience to critically evaluate the debtor's residential mortgage, note and underlying transactions. Important claims and defenses often arise under the Federal Truth in Lending Act ("TILA"), Regulation Z, and a wide variety of tort and statutory claims and defenses available under state law.¹

Moreover, consumer mortgagors are often inundated with offers of "help" from unscrupulous participants in the residential real estate market. These offers may consist of straw-man purchases and equity-sale and lease-back with option to buy schemes, among others. These can often be recharacterized as equitable mortgages and therefore subject to claims and defenses available against mortgages generally.

The consumer bankruptcy attorney must evaluate all of these possibilities in order to assist the debtor in completing his schedules. Failure to assert a potential claim or defense in schedules could be fatal to subsequently bringing such a claim² and subject the consumer bankruptcy attorney to professional liability.

If the consumer bankruptcy attorney does perceive such a claim and schedules it, important strategic questions arise. Should the case be filed in chapter 7 or chapter 13? If the chapter 13 case is filed, should the mortgage-related action be filed in the bankruptcy court or some other court? Should it be filed prior to bankruptcy? Should the bankruptcy case be filed at all?

These concerns are not limited to consumer bankruptcy attorneys. Chapter 7 trustees must be acutely aware of issues commonly arising in residential mortgages to discharge their obligation to investigate all assets owned by the bankruptcy estate and all claims available to the estate. Chapter 7 trustees should ask each debtor with a consumer mortgage loan transaction to reveal the circumstances behind that loan transaction. Trustees should review the loan origination papers for any irregular transactions. Even a cursory, but standardized and systematic evaluation of mortgage transactions by chapter 7 trustees, especially refinancing transactions, will lead to a surprisingly large number of potential causes of action. The chapter 13 trustee should insist that the debtor's attorney make the same sort of examination. A plan which does not at least consider the validity and enforceability of the largest single obligation in the case, perhaps the obligation which forced the debtor into bankruptcy in the first place, might not be in the best interest of creditors, much less the best interest of the debtor.

When loan transactions can be challenged under TILA and Regulation Z, or under common law theories, the rescission remedy can effectively transform the lender's secured claim into an unsecured claim, or at the very minimum, significantly reduce the amount of the lender's secured claim.³ The consequences to the administration of a

bankruptcy case can be dramatic. When mortgage rescue fraud transactions can be recharacterized as equitable mortgages and avoided or rescinded, the consequences can lead to surplus estates. When tort claims can be brought, establishing that an illegal or unconscionable mortgage transaction necessarily forced the debtor into bankruptcy, substantial damages might be recovered from the participants in the transaction. When lawyers and others aid and abet in the perpetration of fraud, deeper pockets might be found to satisfy legitimate claims against the estate.

While the issues and remedies suggested here are particularly pertinent today, in light of market conditions in the residential mortgage market, they suggest an approach which always should be taken by consumer bankruptcy practitioners, including trustees.

Most, if not all, consumer bankruptcy practitioners have assumed, without question, that a residential mortgage note is valid, enforceable, due and owing in the amount specified by the mortgage lender. One should not make that assumption. Indeed, one should not assume anything.

Who is the Mortgagee?

One can no longer assume that the entity pursuing the claim is in fact the legal holder of the note or mortgage in question. In the past, yet within our professional memory, a residential mortgage would be originated by a local savings and loan association and held in that institution's portfolio. The capital for such a loan would be derived from local savings accounts of local customers. Mortgage capital would be raised in the community and reinvested in the community.

After the implosion of the savings and loan industry, a new capital formation model developed. Mortgages were originated by mortgage brokers and wholesalers, who

in turn would sell their mortgage paper in a secondary market. Mortgage paper now becomes security for a pool of bonds known as “collateralized debt obligations” and derivative products. The detail in the endorsement and negotiation of mortgage notes and the assignment and due recordation of transfers of interests in mortgages has become less than punctilious. Does this matter? Perhaps.

Those economically interested in mortgages in the secondary residential mortgage market contend that they are holders in due course of the mortgage notes and related mortgages. In many instances, mortgagors are defrauded in the original extension of credit. While a holder in due course takes free of personal defenses,⁴ it must take the note by negotiation, without notice that it has been dishonored, without notice of an unauthorized signature, and without notice of any defenses or claims of recoupment.⁵

Suppose that the note has not been negotiated in good faith for value prior to the debtor’s default, or the holder is raising fraud or recoupment claims against the originator of the loan? Such defenses would be available against a subsequent holder, who is not a holder in due course.

Bankruptcy practitioners should review the records of the applicable recorder or registrar of deeds to see if the mortgagee who asserts a claim is the mortgagee on the original document. Many lenders avoid the need to make a recorded assignment of a mortgage by utilizing Mortgage Electronic Registration System as nominee. This does obviate the need to make a recorded assignment of the mortgage, but it does not obviate the need to negotiate the note.

Chapter 7 trustees are frequently confronted with motions by the putative holder of the mortgage for relief from the automatic stay within days of the commencement of

the case. While many courts require mortgagees to attach copies of the mortgage and notes as to which stay relief is sought, many other courts do not. The moving party may refrain from pleading a) the date and original holder of the note and mortgage; b) the recording information for the original mortgage; and c) any facts about the assignment or transfer of the mortgage and note from the original holder to the current holder.

These are not petty details. On October 31, 2007, Judge Christopher Boyko of the United States District Court for the Northern District of Ohio dismissed fourteen cases in which plaintiffs sought to foreclose on securitized residential mortgages in default.⁶ The opinion was featured in a front-page article in *The New York Times* on November 15, 2007. Plaintiffs, typically bond trustees for collateralized debt obligations, were unable to establish that they were the holders of the notes or assignees of the mortgagees in question. The Ohio foreclosure cases carry significant implications in bankruptcy cases.

The holder of the note evidencing the debt should be considered the holder or owner of the corresponding mortgage pursuant to the Uniform Commercial Code.⁷ Nevertheless, a secured creditor ought not to be able to obtain relief from stay absent evidence that it actually is the holder and owner of the note and mortgage.

If the secured creditor perfects its transfer of the note and mortgage after the bankruptcy, and particularly after it becomes aware or should become aware of personal defenses arising from the origination of the loan, it loses its status as a holder in due course.⁸ Indenture trustees for bondholders of collateralized debt obligations rely upon their status as holders in due course to immunize them from substantial defenses which might arise from improper loan origination.⁹ A Michigan Court of Appeals decision, *Bibler v. Arcata*,¹⁰ contains an interesting discussion as to whether a note in a residential

mortgage transaction is a negotiable instrument, holding in the affirmative. To the contrary is *Bankers Trust v 236 Beltway Associates*,¹¹ which held that the note was not a negotiable instrument because on its face there was not enough information to determine the sum due. The note was a variable rate note. Subsequently, the Uniform Commercial Code was amended to provide that variable rate notes could nonetheless be considered negotiable instruments.¹² Nevertheless, each note must be examined carefully to determine if it meets the requirements of negotiability. Absent negotiability, the “investor” can not be considered a holder in due course and will be subject to personal defenses.¹³

The Uniform Commercial Code is clear that one must take an instrument by negotiation, in good faith, and without notice of personal defenses in order to be a holder in due course.¹⁴ In today’s fluid mortgage market, actual negotiation of the note may not have taken place at all. Or it may not take place until at or near the time of foreclosure.

If a debtor in chapter 13 or a trustee in chapter 7 bankruptcy proceedings identifies fraud or other irregularities in the inception of the loan, they will likely be able to assert that the “investor” is not a holder in due course and therefor takes its note subject to all UCC 3-305(a) defenses.

Does the Mortgagee have a Secured Claim?

Too often, it is presumed that the mortgagee has a valid and enforceable secured claim. It is not necessarily so. One cannot overlook formal requisites. Is the mortgage executed properly? Is the mortgage properly notarized or witnessed? Has the mortgage been timely recorded? Failure to adhere to formal requisites can be fatal to the mortgagee’s secured claim. Mortgage transactions are not always conducted in the

decorous circumstances of an escrow office. Surprisingly many transactions are closed in the borrower's homes, or in fast food restaurants or on the hood of a car in a parking lot. Sloppy mistakes can occur under these circumstances. Moreover, mortgages are not always recorded promptly. Sometimes, the mortgage is recorded within 90 days of the commencement of a bankruptcy case and more than 30 days after the mortgage was executed. Under these circumstances a mortgage can perhaps be avoided by a trustee in bankruptcy as a preferential transfer.

Avoidance Actions

Legal Sufficiency of Document, Execution or Recording

Each practitioner must be aware of the local formal requirements. If the mortgage fails to meet the formal requisites, it may be ineffective to create a lien. It is not the intent here to be exhaustive but rather illustrative. For example, in some states, witnesses are required.¹⁵ In some states, failure to properly notarize the mortgage renders it non-recordable or of ineffective notice even if it could otherwise give inquiry notice.¹⁶ In some states, an incorrect legal description renders the mortgage ineffective.¹⁷ In other states, extrinsic evidence might be admitted to establish the correct legal description.¹⁸ It has also been held that a defective legal description might be reformed.¹⁹

Timeliness of Recordation - Preference

If the mortgage is not timely recorded, an action to avoid the mortgage as a preferential transfer might lie. Lenders may claim as a defense that the mortgage was nevertheless recorded substantially contemporaneous with the extension of credit, and therefore, the late perfection of the mortgage was not a preference.²⁰ Two lines of cases have developed on this point. The first suggests that the 30-day period allowed within

which lien perfection²¹ relates back is a “bright-line” test and that liens perfected thereafter may be avoided as a preference without regard to whether they were recorded substantially contemporaneously within the meaning of Section 547(c)(3) of the Bankruptcy Code.²² The second line of cases calls for a flexible case-by-case approach.²³ This issue is presently unsettled and there are well reasoned opinions on both sides of the question. The authorities are collected in *In re Alexander*, cited above at note 21.

Faced with preference claims, lenders sometimes assert an equitable lien or equitable subrogation to the extent that the proceeds of the mortgage were utilized to pay off a prior mortgage obligation. Bankruptcy courts have been split as to whether this vitiates a preference claim.²⁴ Some bankruptcy courts enforce the “safe harbor” provisions of Bankruptcy Code section 547 strictly, holding that a substantially contemporaneous recording more than 30 days after it was executed is insufficient and further holding that equitable subrogation has no applicability.²⁵

Consideration should be given to who has standing to raise such claims. Powers and rights belonging to a trustee must be asserted by the trustee in chapter 7 cases. The debtor has the powers and rights of a trustee only in chapters 11²⁶ and 12.²⁷ Does a chapter 13 trustee have standing to bring such claims? May a debtor bring such claims in the name of the chapter 13 trustee? There are two lines of cases adopting contradictory and opposing views as to whether a chapter 13 debtor enjoys independent standing to exercise the avoidance powers of the trustee. The majority of such cases hold that the debtor’s avoidance powers are limited to the extent necessary to avoid impairment of an exemption pursuant to Section 522(h). Otherwise, chapter 13 debtors do not have independent standing to exercise the trustee's avoidance powers.²⁸

Given the Supreme Court’s strong “plain language” stance regarding the Bankruptcy Code,²⁹ it is hard to imagine how a debtor might have standing to pursue a trustee’s rights under a chapter 13 case where there is explicit authority to do so in chapter 11 and 12, but not in chapter 13.

Defenses, Counterclaims and Recoupment against Mortgagees in Bankruptcy

Introduction

The debtor’s residence is frequently the largest single asset in a consumer bankruptcy case. Accordingly, the debtor’s residential mortgage will be the largest debt in the case. In contrast to the scrupulous attention always given by the debtor’s attorney and trustees to the due perfection, validity and enforceability of secured claims in business cases, little attention or thought has been given over the years to important defenses which might be available against residential mortgages. For years, trustees and debtors have routinely responded “no defense” to motions for relief from the automatic stay presented by mortgage lenders.

Clearly, a large proportion of mortgages have been originated properly, duly perfected and are regular in every respect. However, all too many are not. All too many end up being fully enforced even though substantial claims and defenses might have been interposed. Here, we first examine defenses and counterclaims which may be interposed against residential mortgages in bankruptcy cases. Then, we consider responses which such defenses and counterclaims may evoke. Finally, we focus on particular problems which must be addressed by chapter 7 trustees, chapter 13 trustees, and debtors in such cases.

Truth in Lending Act – Regulation Z

Participants in the consumer bankruptcy process frequently view themselves in a rather narrow role. Chapter 7 trustees tend to focus on liquidation of assets and possibly avoidance actions. Chapter 13 trustees tend to focus on case administration. Debtors' attorneys focus on obtaining a discharge in chapter 7 and plan confirmation in chapter 13.

A key thread often neglected in consumer bankruptcy cases is that the debtor is a consumer. And the fact that the debtor is a consumer means that the debtor has consumer causes of action and defenses which may be interposed.

The Federal Reserve Bank of Chicago says the following about Regulation Z on its website:

Regulation Z establishes uniform methods of computing the cost of credit, disclosure of credit terms, and procedures for resolving errors on certain credit accounts. It also gives consumers the right to cancel certain transactions involving their principal residence.

The credit provisions of the regulation apply to all persons who extend consumer credit more than 25 times a year or, in the case of consumer credit secured by real estate, more than 5 times a year. Consumer credit is generally defined as credit offered or extended to individuals for personal, family, or household purposes, where the credit is repayable in more than four installments or for which a finance charge is imposed.

The major provisions of the regulation require lenders to:

- provide borrowers with meaningful, written information on essential credit terms, including the cost of credit expressed as an annual percentage rate (APR)
- respond to consumer complaints of billing errors on certain credit accounts within a specific period
- identify credit transactions on periodic statements of open-end credit accounts
- provide certain rights regarding credit cards

- provide good faith estimations of disclosure information before consummation of certain residential mortgage transactions
- provide "early" disclosure of credit terms to consumers interested in adjustable rate mortgages (ARMS) and home equity lines of credit
- comply with special requirements when advertising credit.³⁰

Regulation Z, issued by the Federal Reserve Bank, is promulgated pursuant to the Federal Truth in Lending Act. The first section of Regulation Z is worth reading:

Regulation Z, is issued by the Board of Governors of the Federal Reserve System to implement the Federal Truth in Lending Act, which is contained in title I of the Consumer Credit Protection Act, as amended (15 U.S.C. 1601 *et seq.*). This regulation also implements title XII, section 1204 of the Competitive Equality Banking Act of 1987 (Pub. L. 100–86, 101 Stat. 552). Information-collection requirements contained in this regulation have been approved by the Office of Management and Budget under the provisions of 44 U.S.C. 3501 *et seq.* and have been assigned OMB number 7100–0199.

(b) *Purpose.* The purpose of this regulation is to promote the informed use of consumer credit by requiring disclosures about its terms and cost. The regulation also gives consumers the right to cancel certain credit transactions that involve a lien on a consumer's principal dwelling, regulates certain credit card practices, and provides a means for fair and timely resolution of credit billing disputes. The regulation does not govern charges for consumer credit. The regulation requires a maximum interest rate to be stated in variable-rate contracts secured by the consumer's dwelling. It also imposes limitations on home equity plans that are subject to the requirements of §226.5b and mortgages that are subject to the requirements of §226.32. The regulation prohibits certain acts or practices in connection with credit secured by a consumer's principal dwelling.³¹

Regulation Z is not typically considered to be an important weapon in the arsenal of bankruptcy practitioners. Until very recently, it does not appear that any chapter 7 trustee has regularly utilized Regulation Z and TILA in administration of chapter 7 cases.³² Review of the reported decisions suggests that there have been a few “hot-spots” in the nation where Truth in Lending Act and Regulation Z claims have been utilized in chapter 13 cases by debtors.³³ No instance has been found where a chapter 13 trustee has

initiated a Truth in Lending Act or Regulation Z case. A few instances have been found where Truth in Lending Act or Regulation Z cases were pending prior to the bankruptcy case. These tend to relate to issue preclusion concerns for failure to schedule the claim or *Rooker-Feldman* concerns arising because the mortgage foreclosure case in state court has already resulted in a judgment adverse to the debtor.

This article does not propose to present an exhaustive analysis of TILA or Regulation Z. The authoritative work in this area the Truth in Lending Manual published and updated frequently by the National Consumer Law Center.³⁴ Rather, the focus of this segment is to consider the implications of TILA and Regulation Z for all aspects of consumer bankruptcy cases

Overview of TILA – Regulation Z; Fundamental Principles

Congress has legislated extensively on the subject of Consumer Credit Protection.³⁵ In enacting title 41 of Chapter 15 of the United States Code:

The Congress finds that economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit. The informed use of credit results from an awareness of the cost thereof by consumers. It is the purpose of this subchapter to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices.³⁶

There are three highly important sources of law to be considered in analyzing the rights of consumers under TILA.

First, reference must be made to the statute itself. For federal consumer credit rights in mortgage transactions, the source of law is to be found in Parts A and B,

Subchapter I (Consumer Credit Disclosure), Chapter 41 of Title 15 of the United States Code³⁷

TILA, however, cannot be read in a vacuum. One must also carefully consider Regulation Z promulgated by the Federal Reserve Board in order to implement the statute.³⁸ Also of critical importance is the Federal Reserve Board's Official Staff Commentary on Regulation Z.³⁹ The Supreme Court has held that unless the Federal Reserve Board's Official Staff Commentaries are "demonstrably irrational," they are to be treated as dispositive.⁴⁰ As a result, the Seventh Circuit Court of Appeals recently held that TILA is to be interpreted in a hypertechnical fashion in favor of the consumer.⁴¹ In *Hamm*, the Seventh Circuit held that the failure to use the word "monthly" in the Truth In Lending Disclosure Statement afforded the mortgagor an extended three-year right of rescission, holding:

TILA's purpose is achieved by promoting uniformity in credit documents. Atypical terms and forms can confuse borrowers, leading them to agree to credit products that they might have rejected had they understood them properly. For that reason, TILA requires that many items of information be disclosed in specified ways. If a lender does not disclose one such piece of information in the specified way, leaving the borrower to make assumptions, then TILA has been violated.

Although there is an ample body of law dealing with Truth in Lending Act violations, it is surprising how relatively infrequently reported decisions appear in the bankruptcy courts. It appears that legal aid bureaus and consumer advocates who have awareness of the defenses and claims under TILA, as well as defenses to mortgage foreclosure in general, are generally not bankruptcy attorneys. Consumer bankruptcy attorneys, in general, do not have awareness, much less expertise, in defenses to mortgage foreclosures, including consumer credit protections under TILA.

TILA Basics

TILA is applicable to “creditors.”⁴² Only transactions involving “consumers” are covered.⁴³ Under TILA and Regulation Z, a consumer engaged in a covered credit transaction with a credit is entitled to clear, conspicuous and accurate disclosures of the loan terms.⁴⁴ The loan terms must be disclosed in the form of a Truth In Lending Disclosure Statement (“TILDS”)⁴⁵ The TILDS must be given to the borrower before the consummation of the loan transaction.⁴⁶ If the transaction is rescindable, the disclosures must be made to each consumer who has the right to rescind.⁴⁷ Theoretically, one could argue that a separate copy of the TILDS is required for both the husband and wife, for example, making a loan. Cases have not been found on either side of this issue.

In the case of non-purchase money residential mortgages, each consumer must receive two copies of a Notice of Right to Cancel within 3 business days of closing in a form which meets all regulatory requirements.⁴⁸ If the creditor fails to give two copies of a proper Notice of Right to Cancel to each person whose ownership interest in the residential dwelling which is subject to lien, each such person is entitled to an extended three-year right to rescind. The three year statute of repose does not apply to the utilization of rescission under TILA when used in defense to a mortgage foreclosure or for recoupment.⁴⁹ Frequently, consumers receive fewer than two copies each of a proper Notice of Right to Cancel at a closing even though they are asked to, and do, sign a statement on the Notice of Right to Cancel acknowledging that they received the two copies. This acknowledgment, which, in fact, is frequently false, does no more than create a rebuttable presumption that each consumer did receive two copies of the Notice of Right to Cancel.⁵⁰ Upon testimony that the consumer did not receive two copies of

the Notice of Right to Cancel, or indeed, any of the necessary disclosures, the burden then shifts to the creditor or the creditor's assignee to prove that all necessary disclosures and documents were provided.⁵¹

There are a wide variety of instances which might give rise to an extended three-year right to rescind under TILA. For example the Initial Disclosure Statement might have failed to provide or accurately state all of the information required, such as the "Amount Financed," the "Finance Charge," the "Annual Percentage Rate," proper disclosures regarding variable rate loans, proper recitation of the payment schedule, demand feature, late charge features, pre-payment premium features, assumption policies and several others. Moreover, the tolerances for errors in these disclosures are very small.⁵²

Even if the mortgage has been assigned from the original lender to another lender, the subsequent lender is still subject to any right of rescission which might be retained by the consumer.⁵³ Moreover, the assignee is liable for statutory damages for the initial failure to give proper TILA disclosures where the deficiency is apparent on the face of the document.⁵⁴

Mortgage lenders in consumer bankruptcy cases are used to getting their way with very little resistance. So, rescission can be a most powerful right, particularly in the hands of a chapter 7 trustee or a chapter 13 debtor. Upon rescission, "the security interest giving rise to the right of rescission becomes void and the consumer shall not be liable for any amount, including any finance charge."⁵⁵ Within 20 days the creditor must take any action required to cancel the security interest and must return any money paid on the loan.⁵⁶ At that point, the consumer must tender to the creditor the value of the money or

property received.⁵⁷ The tender amount, sometimes referred to as the TILA tender, is reduced by any amount paid on the loan (unless previously returned). Courts can modify the timing of the rescission and the nature of the tender as deemed equitable under the circumstances.⁵⁸

TILA in the Courts

Comparatively few cases involving TILA have arisen in the context of bankruptcy. Most have arisen in either direct actions in federal courts or as counterclaims to mortgage foreclosures in state courts. In the interest of brevity, we focus here particularly on TILA cases in the various federal circuit courts of appeal, or which represent the views of the various circuits. From that point of departure, we then review salient cases involving TILA in the context of bankruptcy.

Supreme Court Decisions

Three relatively recent decisions from the United States Supreme Court bear analysis. *Ford Motor Credit Co. v. Milhollin*⁵⁹ is often cited for basic principles concerning TILA and its relationship with Regulation Z. While holding that Regulation Z does not mandate generalized disclosure of an acceleration clause in a note, the *Milhollin* Court sets out many principles of statutory construction often repeated in subsequent cases in many courts. For example, “a high degree of deference to the FRB staff’s consistent administrative interpretation that the statute and regulations is warranted.”

Moreover, the Court emphasized Congress’ intent to defer to the staff of the Federal Reserve Board relative to its regulations pursuant to the Truth in Lending Act, stating,

“Furthermore, Congress has specifically designated the Federal Reserve Board and staff as the primary source for interpretation and application of truth in lending law. Because creditors need sure guidance through the "highly technical" Truth in Lending Act, S.Rep. No. 93-278, p. 13 (1973), legislators have twice acted to promote reliance upon Federal Reserve pronouncements.”⁶⁰

The Court went on to note: “The enactment and expansion of § 1640(f) has significance beyond the express creation of a good faith immunity. That statutory provision signals an unmistakable congressional decision to treat administrative rulemaking and interpretation under TILA as authoritative.”⁶¹ Accordingly, the Court held that the interpretations of the Federal Reserve Board staff were authoritative and binding. The Court could not engage in “interstitial lawmaking” so long as the Federal Reserve’s rulemaking was not irrational.⁶²

Household Credit Services, Inc. v. Pfennig,⁶³ as *Milhollin*, denied relief to the consumer, holding that an overlimit charge by a credit card issuer to a credit card holder was not a “finance charge” within the meaning of Regulation Z. However, again, the Court reached its conclusion by expressing strong, if not mandatory, deference to the rule-making authority and staff interpretations of the Federal Reserve Board. While recognizing the validity of the Sixth Circuit’s holding that, “as a remedial statute, TILA must be liberally interpreted in favor of consumers,”⁶⁴ the Court nonetheless denied relief to the consumer, holding that an overlimit fee was not a “finance charge” but rather an “other charge which may be charged incident to a plan.” Since the Federal Reserve Board’s rules and interpretations excluded overlimit fees from the definition of “finance charge,” the Court determined that this interpretation was binding upon the courts.

Also noteworthy in context of this discussion is the Supreme Court's decision in *Koons Buick Pontiac GMC, Inc. v. Nigh*.⁶⁵ While this opinion is well known for its conclusion that damages were substantially limited in the case of TILA violations on retail installment sale contracts for automobiles and other personal property, the Court also emphasized Congress' intent in amending TILA to provide for enhanced damages and remedies in the case of violations of TILA involving closed end real estate transactions such as mortgages.⁶⁶

While each of the three Supreme Court cases cited had the effect of limiting remedies available to consumers, the language of the Courts' opinions, particularly *Milhollin*, has often been cited in support of the definitive nature of the Federal Reserve Board's rules and staff interpretations. Perhaps the most impressive example of this view to date is the Seventh Circuit Court of Appeals' 2007 decision in *Hamm v. Ameriquest Mortgage Company*.⁶⁷ There, the Court held that the failure of the TILDS to use the word "month" or "monthly" to describe the periodicity of payments under the borrower's loan compelled granting her an extended three-year period within which to rescind her loan. The court cited *Milhollin* for the proposition that it was required to defer to the Federal Reserve Board Staff Commentary in interpreting the Truth in Lending Act and Regulation Z. The Commentary makes it clear that lenders must specify the payment intervals or frequency on the TILDS. Even if the lender fails to disclose just one piece of required information on the TILDS, it violates TILA. Its signature line in the opinion reverberates throughout the lending industry, "when it comes to TILA, 'hypertechnicality reigns.'" ⁶⁸

The “hypertechnicality” standard is not followed universally. As the Seventh Circuit panel acknowledged, the First Circuit has specifically rejected the “hypertechnicality” standard.⁶⁹ However, when the Seventh Circuit tried to adopt a functional approach in *Carmichael v. Payment Center, Inc.*,⁷⁰ the Federal Reserve Board staff amended its commentary to essentially overrule the opinion and instead, opt for the hypertechnical approach now embraced by that court.

In contrast to *Hamm*, where a rather important term, the periodicity of the loan payments, was left out from the TILDS, in *Santos-Rodriguez*, the Notice of Right to Cancel to the borrower was provided on the “H-8” form for “same lender refinancing” rather than the “H-9” form for “different lender refinancing.” There are some subtle but distinct variations in the borrower’s rescission rights in the former situation compared to the latter. The First Circuit held that the requirements of TILA were met even though the Notice of Right to Cancel was on an incorrect form. It held that there was no requirement that the notice be on any particular form and that the models in appendix to Regulation Z were not mandatory. The First Circuit rejected the Seventh Circuit’s opinion in *Handy*, distinguishing it on the facts as well, and instead embraced an unreported decision from the Sixth Circuit,⁷¹ as well as two cases from the Fifth Circuit, seeming to accept less than perfect notice of rescission rights as long as the notice was “clear and conspicuous.”

The Fourth Circuit not only has declined to strictly enforce TILA, it now seems to have conditioned the borrower’s entitlement to invoke its benefits to the borrower’s equitable and proper conduct in connection with the transaction.⁷² Although the lender failed to provide Notice of Right to Cancel at the closing, the borrower had lied about his income and was not in a position to tender.⁷³ While the court characterized the lender’s

violation as “hypertechnical,” it did not decide the case on the basis of the lender’s violation, but rather on the borrower’s inequitable conduct and inability to tender. The court held that the TILDS was only off by \$100 and therefore was compliant. Accordingly, the new TILDS was not required despite that it was not necessarily in proper form.

The Third Circuit states that the correct standard for failure to comply with TILA is strict liability.⁷⁴ In *Johnson v. Chase Manhattan Bank, USA, NA*,⁷⁵ the Court observed that the specific date on which the right to cancel expires has to be inserted in the Notice of Right to Cancel. Failure to indicate the specific date has not been found to be excusable in any case found by or cited to the court.⁷⁶ **[don’t understand this last sentence]**

While not a decision of a circuit court of appeals, the Eighth Circuit Bankruptcy Appellate Panel’s decision in *Groat v Carlson*⁷⁷ is instructive. The Eight Circuit BAP recognizes the salutary and remedial nature of TILA. However, it read the 1995 amendments to TILA as expressing Congress’ intent that minor errors were not to be considered grounds for rescission. The BAP held that a typographical error referring to the date within which the borrower had to cancel as a date in 2001 rather than 2002 was not seriously misleading and essentially a bona fide clerical error. The BAP also held that nothing in the regulations required the lender to sign the Notice of Right to Cancel.

TILA in the Bankruptcy Courts

Bankruptcy cases that have considered TILA appear almost exclusively in the context of chapter 13 cases, where such claims are pursued by debtors. Cases involving chapter 7 typically have involved converted chapter 13 cases. In a few reported cases,

defendants rightly point out that the TILA case becomes property of the chapter 7 estate and only the chapter 7 trustee has the right to pursue the TILA claim.⁷⁸ To date, no reported decision has been found where the chapter 7 trustee has commenced and pursued a TILA case to judgment.⁷⁹ A chapter 7 trustee's TILA claim attacking a mortgage granted by a debtor to her divorce lawyer was dismissed because the lawyer was not a "creditor" within the meaning of TILA.⁸⁰

The few cases involving TILA in chapter 7 cases seem to address the relative rights of the debtor and the trustee to pursue TILA claims where the debtor claims a large homestead interest in the real estate. For example, in *Layell v. Home Investment Bank*,⁸¹ the debtor commenced a TILA adversary proceeding in the bankruptcy court in response to the lender's motion for relief from stay. Without commenting on the debtor's standing, the Fourth Circuit Court of Appeals dismissed an appeal of that order as interlocutory.

A chapter 7 trustee settled a debtor's class action claim for a minimal amount in excess of the debtor's wild card exemption.⁸² Two Kansas bankruptcy court decisions reach contradictory results on the question of homestead exemptions.⁸³ *In re Ross* appears to be the better reasoned opinion, essentially holding that TILA claims might have aspects which could partake of homestead exemptions and other aspects which might not. More typically, however, TILA claims in the bankruptcy court seem to be pursued in the context of chapter 13.⁸⁴ *Rodrigues* is representative of many cases brought in the Bankruptcy Court in Rhode Island. There, the debtor successfully rescinded a loan which violated the Home Owners Equity Protection Act (HOEPA) provisions of TILA⁸⁵ and also which failed to provide the debtor with two copies of the

Notice of Right to Cancel. The Court found the debtor's testimony credible and that she had rebutted the presumption that she received two such copies by reason of having signed a statement to that effect.⁸⁶

The analysis of Judge Feeney in *Whitley v. Rhodes*⁸⁷ is highly instructive. It demonstrates substantial differences in TILA remedies which might be fashioned in the context of a bankruptcy case as compared to non-bankruptcy cases. There, the debtor filed chapter 13 shortly after a private mortgage lender sought to foreclose. Shortly thereafter, the debtor commenced an adversary proceeding seeking a determination that the mortgage had been rescinded by reason of a variety of TILA violations as well as statutory damages and actual damages under a variety of state law theories.

First, the *Whitley* Court held that the mortgage loan violated TILA because several fees, costs and expenses charged to debtor at the mortgage closing properly should have been included in the finance charge. Accordingly, the finance charge was materially understated. Material understatement of the finance charge renders the TILDS invalid and triggers an extended three-year right to rescission.

Because the case arose in the context of a bankruptcy case, Judge Feeney did not condition rescission on an immediate tender by the debtor, even though she acknowledged that she had great flexibility in fashioning the tender requirement. Relying upon *In re Myers*,⁸⁸ Judge Feeney stated:

In *Myers*, Bankruptcy Judge Hillman adopted the reasoning advanced by the district court in *In re Celona*, 98 Bankr. 705, 707 (E.D. Pa. 1989), a case in which the court stated that "'judicial preconditioning of cancellation of the creditor's lien on the customer's tender is inappropriate in bankruptcy cases.'" This Court can conceive of circumstances where the statutory right to rescind might be conditioned upon an obligor's tender based upon equitable considerations, in which case a determination as to whether the effect of a rescission notice is a substantive right not subject

to discretionary action or a procedural step subject to the last sentence of section 1635(b); however, this case is not one of them. [footnote omitted] As the court stated in *Aquino v. Public Fin. Consumer Discount Co.*, 606 F. Supp. 504 (E.D. Pa. 1985), "courts in their effort to insure a just result should not forget that the TILA 'was passed primarily to aid the unsophisticated consumer'" and that it was "'intended to balance scales thought to be weighted in favor of lenders and ... to be liberally construed in favor of borrowers.'" *Id.* at 509, citing *Thomka v. A.Z. Chevrolet, Inc.*, 619 F.2d 246, 248 (3d Cir. 1980), and *Bizier v. Globe Financial Services, Inc.*, 654 F.2d 1, 3 (1st Cir. 1981).

Having concluded that the mortgage was rescinded, the bankruptcy court noted that Rhodes, the mortgagee, by then himself a chapter 7 debtor whose interests were being represented by a bankruptcy trustee, was scheduled as a creditor in Whitley's bankruptcy. As a result of Whitley's timely rescission, the court held that Rhodes was limited to an unsecured claim in Whitley's bankruptcy estate:

The Court finds that the Debtor's notice of rescission was valid (the omission of the words "Services" in the address preceding the salutation was harmless as Rhodes was correctly identified in the first sentence of the rescission letter). Accordingly, upon receipt of the notice, the mortgage was void, and Rhodes's claim became an unsecured claim. See Regulation Z, 12 C.F.R. § 226.23(d)(1)

And to add insult to injury, since Rhodes' chapter 7 trustee failed to timely file a proof of claim in Whitley's chapter 7 case, Rhodes' unsecured claim was disallowed.

A more recent opinion, *In re Ramirez*,⁸⁹ a decision of the federal district court of Kansas, on appeal from a decision of a chapter 13 bankruptcy court, reflects the current majority view. There, the district court affirmed the bankruptcy court's decision that the mortgage loan was subject to rescission owing to improper disclosures. The court also affirmed the finding as to the amount of the tender which was required under TILA. However, the court found that the mortgagee and the debtor-borrower had "reciprocal obligations" under TILA. The purpose of rescission and reduction of the mortgagors'

claim was to allow the borrower the opportunity to refinance the property and to pay the lender that which it was entitled to after having credited the debtor-borrower for the amounts of principal, interest and fees improperly collected. The court stated:

Under § 1635(b), the Ramirezes were obligated to tender property to Household upon their rescission of the loan and after Household had returned all costs and interest. As recognized by the bankruptcy court, the parties had “reciprocal payment obligations under the TILA and § 1635(b) and Regulation Z § 226.23(d)(2) and (3).” The Ramirezes’ claim for damages accrued as a part of the Rescission Violation and Household’s claim for the reciprocal payment obligation arose out of the same transaction, that is, the Ramirezes’ rescission. Accordingly, the obligations were in fact part of the same transaction for purposes of recoupment, and the bankruptcy court properly exercised its discretion to deduct the Rescission Violation damages from the post-rescission balance due Household.

Essentially, *Ramirez* allows the mortgagee a secured claim in the “TILA tender” amount of the mortgage less the amount to which the mortgagor was entitled by reason of the offsetting TILA rescission damages. Both the *Whitley* or the *Ramirez* formulations are highly beneficial to chapter 13 debtors. Further, either the *Whitley* or the *Ramirez* formulation would be highly beneficial to any chapter 7 trustee who might choose to pursue TILA claims.

The *Rooker-Feldman* doctrine⁹⁰ is often raised as a defense to TILA claims in chapter 13 cases. While debtors may have the right to file chapter 13 cases after a foreclosure judgment in state court but before sale, and while the TILA claim theoretically exists so long as the borrower has an interest in the property, many courts hold that TILA cases cannot be pursued after the state court enters a judgment of foreclosure since the TILA claim could have been raised in the state court foreclosure proceeding.⁹¹ A claim for rescission under TILA could essentially undo a state court mortgage foreclosure judgment. So the TILA claim is said to be “inextricably

intertwined” with the foreclosure case for purposes of *Rooker-Feldman* analysis. Thus, a judgment of foreclosure in the state court will be the death knell for a subsequent TILA case in the bankruptcy court or anywhere else. Of course, there is nothing to stop a trustee in a chapter 7 case from intervening in the state court mortgage foreclosure to interpose the TILA claim prior to judgment and sale.

The Supreme Court has made clear in *Exxon Mobil v. Saudi Basic Indus. Corp.*,⁹² that the *Rooker-Feldman* doctrine applies only where the state court disposition is final. *Query*: is a foreclosure case final after judgment or only after sale and confirmation of the sale, for *Rooker-Feldman* purposes? In *In re Hodges (Hodges v. CIT Corporation)*⁹³ Bankruptcy Judge Goldgar ruled that a judgment of foreclosure was not final because there were numerous steps to be taken after the judgment of foreclosure and prior to the time that the defendant became a “state court loser” for *Rooker-Feldman* purposes.

At least one case has allowed a chapter 13 trustee to pursue a TILA claim.⁹⁴ In that case, the chapter 13 trustee filed a proof of claim for a creditor specifically so that she could object to it and file a TILA claim against it. That level of zeal is rarely demonstrated by chapter 13 trustees.

An issue unique to bankruptcy jurisdiction is whether a TILA case for rescission or statutory damages is a core or non-core proceeding. Cases which have considered this have reached both conclusions.⁹⁵ Given that the TILA case does not seem to arise under the bankruptcy code or the case itself, it seems more likely than not that a court would treat a TILA cases as “related to” the main bankruptcy case for core proceeding purposes. As such, after trial, report and recommendation to the district court is called for along with de novo appellate review.

Very high interest rate loans may lead to not only rescission remedies, but also assignee liability pursuant to the provisions of the Home Owner Equity Protection Act of 1994 (HOEPA).⁹⁶ HOEPA amended TILA in 1994 to require enhanced disclosures for very high interest rate mortgage loans. This act is powerful in that it imposes assignee liability. However, the market has responded to HOEPA by, essentially, eliminating loans which would fall within its ambit. So the statute essentially serves as a cap on interest rates for loans sold to the secondary market.⁹⁷

Nevertheless, HOEPA can be a formidable weapon when used to attack mortgage rescue transactions, particularly sale-leaseback transactions which can be recast as equitable mortgages.⁹⁸ The entire topic of mortgage rescue fraud, as well as the role HOEPA can play in response, is discussed below.

State Law Claims

Mortgage transactions that might be subject to rescission or statutory damages are often originated under dubious circumstances. Mortgage originators may have committed fraud or misrepresented terms to the prospective borrower. Mortgage brokers may have engaged in false advertising. They may have offered an attractive mortgage to the borrower but ended up switching the borrower to a higher rate mortgage with more onerous terms. They may have taken advantage of a customer because of race, nationality or language. They may have taken advantage of a person of advanced age.

A wide array of statutes exist at the state level throughout the United States. They may be generally referred to as UDAP statutes, that acronym referring to Unfair and Deceptive Acts and Practices.⁹⁹ Here, we attempt to report as many of these statutes as possible. There may be other statutes that practitioners in a particular state might be

familiar with and all readers are invited to inform the author of statutory provisions available in their state so that a more complete table can be provided. A comprehensive analysis of each state’s consumer fraud and deceptive business practice acts is beyond the scope of this paper, but such an analysis has been published and is available online.¹⁰⁰

State	Statute Name	Codification
Alabama	Deceptive Trade Practices Act	Code of Alabama Title 8, Chapter 19 §§ 8-9-1 – 8-9-15
Alaska	Consumer Protection Act,	AS 45.50.471 through 45.50.561;
Arizona	Consumer Fraud Act	A.R.S. 44-1521
Arkansas		Arkansas Code Ann § 4-88-101 <i>et seq</i>
California		Bus. & Prof. Code §§ 17200 <i>et seq.</i> , and 17500 <i>et seq.</i>
	Consumers Legal Remedies Act	Cal. Civil Code § 1750 <i>et seq.</i>
Colorado	Colorado Consumer Protection Act	§6-1-101 CRS (2003)
Connecticut	Connecticut Unfair Trade Practices Act	Conn. Gen. Stat. 42-110(b)
Delaware		6 Delaware Code § 2511 <i>et seq</i>
Florida	Florida Deceptive and Unfair Trade Practices Act	Florida Stat. 501.201 <i>et seq.</i>
Georgia	Georgia Fair Business Practices Act of 1975	O.C.G.A 10-1-390 <i>et seq.</i>
Hawaii		Hawaii Rev. Stat. §480-2 and §487-5(6)
Idaho	Consumer Protection Act	Idaho Code §§ 48-601-48-619
Illinois	Consumer Fraud and Deceptive Business Practices Act	815 ILCS §§ 505/1 -505/12
	Uniform Deceptive Trade Practices Act	815 ILCS §§ 510/1-510/7
Indiana	Deceptive Consumer Sales Act	Ind. Code Ann. §§22-5-0.5-1 – 22.5-0.5-12
Iowa		Iowa Code §§714.16-714.16A
Kansas	Consumer Protection Act	Kan. Stat. Ann. §§50-623-640
Kentucky	Consumer Protection Act	Ky. Rev. Stat §§ 367.10-367.990
Louisiana	Unfair Trade Practices and Consumer Protection Law	La. Rev. Stat. Ann. §§ 51.1401-51:1420
Maine	Unfair Trade Practices Act	Me. Rev. Stat. Ann. Tit. 5 §§205A – 214
	Uniform Deceptive Trade Practices Act	Me. Rev. Stat. Ann. Tit. 10 §§1211-1216
Maryland	Maryland Consumer Protection Act	Md. Com. Law Code Ann. §§ 13-101-13-

		501
Massachusetts	Regulation of Business Practice and Consumer Protection Act	Mass. Gen. Laws. Ann ch93A
Michigan	Michigan Consumer Protection Act	M.C.L. 445.901 <i>et seq</i> M.S.A. 19.418(1) <i>et seq</i>
Minnesota	Minnesota Prevention of Consumer Fraud Act	Minn. Stat. 325F.69 <i>et seq.</i>
Mississippi	Mississippi Consumer Protection Act	Miss. Code. Ann. §§75-24-1 (Rev. 2000)
Missouri		R.S.Mo. ch. 407.010 to 407.130
Montana		M.C.A. 40-14-101 <i>et seq</i>
Nebraska	Nebraska Consumer Protection Act Uniform Deceptive Trade Practices Act	Neb. Rev. Stat §§ 59-1601 <i>et seq.</i> Neb. Rev. Stat §§ 87-301 <i>et seq.</i>
Nevada	Nevada Deceptive Trade Practices Act	Nev. Rev. Stat. 598.0903-598.0999
New Hampshire		N.H. Rev. Stat. Ann. 358-A
New Jersey	New Jersey Consumer Fraud Act.	N.J.S.A. 56:8-1 <i>et seq.</i>
New Mexico	New Mexico Unfair Trade Practices Act	NMSA §57-1-2 <i>et seq.</i>
New York		N.Y. Gen. Bus. Law §§ 349 & 350 Executive Law § 63(12)
North Carolina	North Carolina Unfair and Deceptive Trade Practices Act	N.C.G.S. §75-1.1 <i>et seq.</i>
North Dakota		NDCC Sections 51-15-01 <i>et seq.</i>
Ohio	Ohio Consumer Sales Practices Act	R.C. § 1345.01 <i>et seq.</i>
Oklahoma	Oklahoma Consumer Protection Act	15 O.S. §§751 <i>et seq.</i>
Oregon	Oregon Unlawful Trade Practices Act	ORS 646.605 <i>et seq.</i>
Pennsylvania	Unfair Trade Practices and Consumer Protection Law	73 P.S. §201-1 <i>et seq</i>
Rhode Island	Unfair Trade Practice and Consumer Protection Act	R.I. Gen. Laws § 6-13.1-1, <i>et seq</i>
South Carolina	Unfair Trade Practices Act,	S.C. Code Ann. §39-5-10 <i>et seq.</i>
South Dakota	South Dakota Deceptive Trade Practices Act	SDCL Ch 37-24
Tennessee	Tennessee Consumer Protection Act	Tenn. Code Ann. §48-18-101 <i>et. Seq.</i>
Texas	Texas Deceptive Trade Practices and Consumer Protection Act	Tex. Bus. and Com. Code § 17.41 <i>et seq.</i> (Vernon 2002 and Supp. 2003)
Utah		Title 13 of the Utah Code
Vermont	Consumer Fraud Act	9 V.S.A. § 2451 <i>et seq.</i> Sec. 100.18(1)
Virginia	The Virginia Consumer Protection Act	Va. Code Section 59.1-196 <i>et seq.</i>

Washington	Unfair Business Practices/Consumer Protection Act	R.C.W. 19.86
West Virginia		Code Section 46A-1-101 <i>et seq.</i>
Wisconsin	Fraudulent Representation Unfair Business Practices	Wis. Stat. 100.18 Wis. Stat 100.20 Wis. Stat. 100.27
Wyoming	Wyoming Consumer Protection Act	Wyo. Stat. Ann §§40-12-101 <i>et seq.</i> (2003)§

UDAP claims essentially sound in tort. Bankruptcy practitioners, particularly bankruptcy trustees and consumer bankruptcy attorneys, are not accustomed to thinking in terms of tort. However, pursuit of such claims could turn a no-asset case into a surplus case. Trustees and bankruptcy attorneys can at the very minimum learn to identify the existence and potential of such claims and then associate themselves with counsel who knows how to pursue them.

Common Law Theories

It is common in mortgage related litigation for claims to be raised for a variety of tort related theories, including, but not limited to, common law fraud, intentional misrepresentation, negligent misrepresentation, aiding and abetting fraud, fraud in the inducement and conspiracy. Bankruptcy practitioners can ask debtors who are forced into bankruptcy by predatory mortgage lenders about the facts and circumstances behind the origination of their loan.

Clearly, not every subprime mortgage loan will give rise to any or all of the suggested causes of action. However, a startlingly large proportion of subprime loans arose under highly questionable circumstances. Effective representation of debtors as well as effective administration of bankruptcy estates by trustees demands that these questions be asked and that these claims be pursued when appropriate.

Mortgage Rescue Fraud

Debtors in bankruptcy frequently have been victims of mortgage rescue fraud.¹⁰¹ A common scenario involves stripping equity from the victim's home in order to "save the house" from foreclosure. This frequently involves a quitclaim deed to the "investor" or "rescuer" who in turn might provide a lease to the homeowner and an option to "buy back" the property at a later date. These schemes, when examined closely, are no more than equitable mortgage transactions. And if the mortgages are negotiated through an intermediary, like a broker or some other financial advisor, these equitable mortgages invariably will be subject to the enhanced disclosure requirements of HOEPA.¹⁰² The "rescuer's" almost invariable failure to think about TILA or HOEPA, much less to comply with it, will result in an almost certain opportunity to rescind the loan transaction and get the consumer's money back from the predatory lender.

The author has successfully pursued TILA and HOEPA claims in his role as trustee both in the bankruptcy court and the Illinois state courts. To date, these claims have been framed as complaints to avoid fraudulent transfers. However, they also interpose HOEPA claims to give rise to assignee liability. They also partake of fraud, conspiracy, aiding and abetting fraud and breach of fiduciary duties as against other participants in this sort of highly orchestrated transaction.¹⁰³ These additional theories can be exceptionally useful as participants in such transactions may have assets, errors and omissions insurance or title insurance to provide a source of payment.

The laws relating to equitable mortgages as well as statutes specifically directed to mortgage rescue fraud and predatory lending are evolving rapidly. Internet blog resources cited below are extremely comprehensive and current, and therefore highly recommended to all readers of this work.¹⁰⁴ "The Home Equity Theft Reporter Cases &

Articles” is perhaps the finest internet resource on this subject. The anonymous author of this material speaks in the first person and has provided broad and deep materials which are up to the minute and national in scope. This author’s public service should be publicly acknowledged and emulated.

Mortgage Servicing Claims

Improper origination of loans is not the only ground for potential claims in bankruptcy cases. Mortgage servicing has also been the source of many abuses, especially in the subprime market. Perhaps the most notorious case is *Nosek v Ameriquest Mortgage Corporation*.¹⁰⁵ There, the scope of the mortgage servicing abuses was so great that substantial damages were awarded to the debtor for the mortgage servicer’s violations of the Real Estate Settlement Procedures Act (“RESPA”). Pursuant to RESPA, a borrower is entitled to make a Qualified Written Request¹⁰⁶ to the loan servicer. Within 20 business days, the servicer must acknowledge the Request and within 60 business days, the servicer must respond to the Request with information regarding the present ownership of the note and mortgage and the loan history and application of payments under the loan. Abuses in the servicing industry have become almost legendary. Trustees and debtors, through consumer bankruptcy attorneys, should know their rights and pursue them as necessary.¹⁰⁷

Conclusion

Today’s widespread residential mortgage foreclosure rate is as high as it has been in a generation. The impact on housing and financial markets is massive. However, the impact on debtors and bankruptcy estates is also profound. There are ample tools for participants in the bankruptcy process to vindicate important rights for themselves, their

clients, and the estates for which they are fiduciaries. Bankruptcy courts should become increasingly aware of these issues and tools as they are likely to be confronted by them more frequently for the next several years.

¹ This work is a follow-on to Riley, L. *The Bankruptcy Perspective: Predatory Lending in the Home Mortgage Market*, revised with the assistance of the author in 2007 and published in the 2007 NORTON ANNUAL SURVEY OF BANKRUPTCY LAW.

² *Donaldson v. Bernstein*, 104 F.3d 547, 555-56 (3rd Cir. 1997); *In re Coastal Plains*, 179 F.3d 197 (5th Cir. 1999); *reh. den.* 102 F.3d 128. cert den. sub nom. *Mims v. Browning Mfg.* 528 US 1117 (2000). *D & K Properties Crystal Lake v. Mutual Life Insurance Company of New York*, 112 F.3d 257 (7th Cir. 1997); *Hamilton v. State Farm Fire & Cas. Co.*, 270 F.3d 778 (9th Cir. 2000); *Burnes v. Pemco Aeroplex, Inc.* 291 F.3d 1282 (11th Cir. 2002).

³ *In re Merriman* 329 B.R. 710 (D. Kan. 2005); *In re Ramirez*, 329 B.R. 727 (D. Kan. 2005).

⁴ Uniform Commercial Code § 3-302.

⁵ Uniform Commercial Code § 3-305(a).

⁶ *In re Foreclosure Cases*, 2007 WL 3232430 (N.D. Ohio Oct. 31, 2007).

⁷ Uniform Commercial Code §§ 9-102(a)(72)(D), 9-109(a)(3), 9-203(g), 9-308(e).

⁸ Uniform Commercial Code § 3-305(a).

⁹ S. Venkatesan *Abrogating The Holder In Due Course Doctrine In Subprime Mortgage Transactions To More Effectively Police Predatory Lending*; Eggert, Kurt, *Held Up in Due Course: Predatory Lending, Securitization, and The Holder in Due Course Doctrine*. CREIGHTON LAW REVIEW, Vol. 35, p. 503, 2002 The New York University Journal of Legislation and Public Policy.(2004); G. Maggs, *The Holder in Due Course as a Default Rule* 32 Ga. Law Rev. 33 (1998).

¹⁰ 2005 WL 3304127 (Mich. App. 2005).

¹¹ 865 F. Supp. 1186, 1192 n.7 (E.D. Va. 1994).

¹² Uniform Commercial Code §§3-104(1)(b), 3-106(1).

¹³ *Ingram v. Earthman* 993 S.W.2d 611 (Tenn. Ct. of App, Nashville 1998), *cert den. sub nom. Earthman v. Ingram*, 528 U.S. 986

¹⁴ Uniform Commercial Code §§ 3-302, 3-305, 3-306.

¹⁵ See, e.g. South Carolina Code of Laws 30-5-30.

¹⁶ *In re: Cocanougher (MG Investments, Inc .v.Johnson)* 2007 Fed Appx. 0013P (6th Cir. BAP 2007) (Kentucky law).

¹⁷ *Lindquist v. Household Indus. Fin. Co. (In re Vondall)*, 2007 Bankr. LEXIS 755 (BAP 8th Cir. March 16, 2007). (Venters, BJ) (Minnesota law).

¹⁸ *In re Duback*, (04-12247 Bkrcty. D.R.I. August 15, 2005).

¹⁹ *In re O'Malley* (03-63315 Bkrcty, N.D. NY August 5, 2004).

²⁰ *In re Alexander*, 219 B.R. 255 (Bankr. D. Minn. 1998).

²¹ 11 USC §363(c) (3). Note that this section only applies to purchase money liens. 11 USC § 363(c) (B) (iii), (iv). Accordingly, it does not apply to other financing transactions.

²² *Ray v. Security Mutual Finance Corp. (In re Arnett)*, 731 F.2d 358 (6th Cir.1984).

²³ *Pine Top Insurance Co. v. Bank of America National Trust Savings Ass'n*, 969 F.2d 321 (7th Cir.1992).

²⁴ Compare *In re Pearce* 236 B.R. 261 (Bkrcty.S.D. Ill. 1999) (no subrogation in the case of a preference claim) to *Rinn v. First Union Nat'l Bank of Maryland*, 176B.R. 401 (D.Md.1995); *In re Hedrick (Gordon v. NovaStar)* (Bankr. N.D. GA 04-92733 Aug. 31, 2005) (subrogation permitted).

²⁵ *In re Lewis (Boyd v. Superior Bank)* (Bankr. WD MI ST 00-03660 Nov. 10, 2001)

²⁶ 11 USC § 1107.

²⁷ 11 USC § 1203.

²⁸ See, e.g., *In re Stangel*, 219 F.3d 498 (5th Cir. 2000), cert. denied, 532 U.S. 910 (2001); *In re Merrifield*, 214 B.R. at 365; *In re Miller*, 251 B.R. 770 (Bankr. E.D. Mass. 2000); *In re Dudley*, 38 B.R. 666 (Bankr.

M.D. Pa. 1984); *But see, In re Ottaviano*, 68 B.R. 238 (Bankr. D. Conn. 1986); *In re Ciavarella*, 28 B.R. 823 (Bankr. S.D.N.Y. 1983).

²⁹ *E.g., U.S. v. Ron Pair Enterprises*, 489 U.S. 235 (1989)

³⁰ http://www.chicagofed.org/consumer_information/regulations_that_protect_consumers.cfm#regulationz

³¹ 12 CFR §226.1. For up to the minute and easily searchable electronic version of Regulation Z, one should utilize the electronic Code of Federal Regulations, available at www.ecfr.gpoaccess.gov

³² The author first advocated for the utilization of Truth in Lending Act claims in chapter 7 cases by bankruptcy trustees in Leibowitz, D. *TILA Can be a Trustee's Best Friend*, NABTALK 2007 Volume: 23-1

³³ Kansas and Rhode Island seem to be two jurisdictions with a disproportionate number of TILA cases in Chapter 13. As will be discussed later, TILA cases have also been brought in Philadelphia bankruptcy courts, but have been met with a fair degree of resistance by bankruptcy judges there.

³⁴ Renuart, E, Keest, K, Cohen, A, Wu, C.C., Carter, C., Thompson, D., Sheldon, J., *Truth in Lending* 6th Ed. 2007 NATIONAL CONSUMER LAW CENTER ISBN 978-1-60248-019-2

³⁵ 15 USC §1601 et seq.

³⁶ 15 USC § 1601(a)

³⁷ 15 USC §§1601-1615; 1631-1639

³⁸ 12 CFR §226 ,

³⁹ 12 CFR §226.36, Supplement I

⁴⁰ *Ford Motor Credit v. Milhollin*, 444 U.S. 555, 565 (1980)

⁴¹ *Hamm v. Ameriquest*, 506 F. 3d 525 (7th Cir. 2007); *but see e.g., Santos-Rodriguez v. Doral Mortgage Corp.*, 485 F.3d 12, 17 n.6 (1st Cir. 2007)

⁴² 15 USC §1602(f) (1). A creditor is one who, “regularly extends, whether in connection with loans, sales of property or services, or otherwise, consumer credit which is payable by agreement in more than four installments or for which the payment of a finance charge is or may be required” The term “regularly extends” is further defined in Regulation Z, 12 USC § 226.2 (17) note 3. This definition is highly important as a creditor must be involved in at least 5 times during the prior year for residential dwelling transactions in order to be within the scope of the regulation.

⁴³ 15 USC § 1603(3) exempts, “Credit transactions, other than those in which a security interest is or will be acquired in real property, or in personal property used or expected to be used as the principal dwelling of the consumer, in which the total amount financed exceeds \$25,000.”

⁴⁴ 12 CFR § 226.18. The entire text is not quoted here. Suffice it to say that each disclosure is mandatory and they are enumerated from subparagraphs (a) through (r).

⁴⁵ 12 CFR §227.17. a) *Form of disclosures*. (1) The creditor shall make the disclosures required by this subpart clearly and conspicuously in writing, in a form that the consumer may keep.

⁴⁶ 12 CFR §227.17(b). *Williams v. Chartwell Financial Services., Ltd.*, 204 F.3d 748,751 (7th Cir.2000); *In re Ralls*, 230 B.R. 508, 515 (Bankr.E.D.Pa.1999); *see* 15 U.S.C. § 1638(b) (1); 12 C.F.R. § 226.17(a) (1).

⁴⁷ 12 CFR 227.17(d).

⁴⁸ 12 CFR §226.23(b) (1). As in the case of the TILDS, the format and contents required in the Notice of Right to Cancel are highly specific and detailed. Any failure to meet any of the specific requirements in §226.23(b)(1) could lead to an extended right to rescind, limited only by the three year statute of repose provided for under the Truth in Lending Act and Regulation Z.

⁴⁹ *See, e.g. 735 ILCS 5/13-207. Bank of New York v. Heath*, 2001 WL 1771825, at *1 (Ill. Cir. Oct. 26, 2001).

⁵⁰ 15 USC § 1635(c).

⁵¹ *E.g. In re Williams*. 291 B.R. 636 (Bankr. E.D. Pa. 2003).

⁵² For example, the annual percentage rate must be within a tolerance of .125% for a “regular” fixed rate loan and within .250% for an “irregular” variable loan. 12 CFR § 226.22(a). It can be very difficult to calculate the proper annual percentage rate since the loan must be calculated to the point where it reaches what is known as the “fully indexed rate”, meaning the index at the inception of the loan plus the margin, or basis points in excess of the index, in the case of all variable rate loans. Then, the stream of payments at varying interest rates must be calculated and averaged out over the term of the loan to calculate the annual percentage rate for TILA disclosure purposes. The office of the controller of the currency offers a tool to assist in making this determination online at: <http://www.occ.treas.gov/efiles/disk1/apr.htm>. Another useful tool is available at <http://www.finance.cch.com/sohoApplets/MortgageApr.asp>. Similarly, the tolerances for errors in determining the finance charge are small. The finance charge must be accurate

within \$100 in the case of original actions brought by the consumer and within \$35 in the case of defenses by the consumer against mortgage foreclosure. 12 CFR § 226.23(a) (3).

⁵³ 15 USC §1641(c).

⁵⁴ 15 U.S.C. § 1641(a); *See Ramadan v. Chase Manhattan Corporation*, 229 F.3d 194, 195 (3d Cir. 2000).

⁵⁵ 12 CFR § 226.23(d) (1).

⁵⁶ 12 CFR § 226.23(d)(2).

⁵⁷ 12 CFR § 226.23(d)(3).

⁵⁸ 12 CFR § 226.23(d)(4).

⁵⁹ 444 U.S. 555 (1980).

⁶⁰ *Id* at 566.

⁶¹ *Id* at 567-568 (footnote omitted).

⁶² *Id* at 568.

⁶³ 541 U.S. 232 (2004).

⁶⁴ 295 F. 3d 522, 528 (CA6 2002).

⁶⁵ 543 U.S. 50 (2004).

⁶⁶ “The purpose of the 1995 amendment is not in doubt: Congress meant to raise the minimum and maximum recoveries for closed-end loans secured by real property. There is scant indication that Congress simultaneously sought to remove the \$1,000 cap on loans secured by personal property.”

⁶⁷ 506 F3d 525 (7th Cir. 2007).

⁶⁸ *Handy v. Anchor Mortgage Corp.*, 464 F.3d 760, 764 (7th Cir. 2006); *but see Vermurlen v. Ameriquest Mortg. Co.*, 2007 WL 2963637 (W.D.Mich. Oct 09, 2007)

⁶⁹ *See, e.g., Santos-Rodriguez v. Doral Mortgage Corp.*, 485 F.3d 12, 17 n.6 (1st Cir. 2007).

⁷⁰ 336 F.3d 636, 641 (7th Cir. 2003).

⁷¹ *Mills v. EquiCredit Corp.*, 172 Fed. Appx. 652, 656 (6th Cir. 2006); *See, e.g., Veale v. Citibank*, 85 F.3d 577, 581 (11th Cir. 1996), *cert. denied* 520 U.S. 1198 (1997) (“TILA does not require perfect notice; rather it requires a clear and conspicuous notice of rescission rights.”); *Smith v. Chapman*, 614 F.2d 968, 972 (5th Cir. 1980).

⁷² “In *Mars v. Spartanburg Chrysler Plymouth, Inc.*, 713 F.2d 65 (4th Cir. 1983), this Court held that the provisions of TILA must be “absolutely complied with and strictly enforced.” *Id.* at 67. This was not to imply, however, that the Act’s requirements should not be reasonably construed and equitably applied.” *American Mortgage Network v. Shelton* (06-1576 4th Cir. May 14, 2007).

⁷³ *See also, Yamamoto v. Bank of New York* 329 F.3d 1167, 1172 (9th Cir. 2003), *cert den.* 540 U.S. 1149 (2004).

⁷⁴ *In re Porter*, 961 F.2d 1066, 1078 (3d Cir. 1992).

⁷⁵ (ED PA 07-526 decided July 11, 2007).

⁷⁶ *See, e.g. Semar v. Platte Valley Fed. Sav. & Loan Ass’n*, 791 F.2d 699, 704 (9th Cir. 1986); *Williamson v. Lafferty*, 698 F.2d 767 (5th Cir. 1983); *Mayfield v. Vanguard Sav. & Loan Ass’n*, 710 F. Supp. 143 (E.D. Pa. 1989); *In re Armstrong*, 288 B.R. 404 (Bankr. E.D. Pa. 2003).

⁷⁷ 8th Cir. BAP 06-6071NE decided May 24, 2007.

⁷⁸ *See United States v. Whiting Pools, Inc.*, 462 U.S. 198, 205 n.9 (1983) (estate property includes causes of action). *Also see In re Polis*, 217 F.3d at 904 (holding when a debtor was entitled to claim up to \$900 of a TILA claim as exempt under the Illinois wildcard statute, the exemption conferred standing on the debtor to bring a class action suit; but, because of the trustee’s lack of interest in suing the creditor, the court would decline to examine the question of whether the debtor or the trustee should control the litigation). *In re Smith*, 640 F.2d 888, 890 (7th Cir. 1981) quite explicitly holds that the chapter 7 trustee has the sole standing to pursue a TILA claim for a debtor in Chapter 7.). To the same effect, *see In re Polis*, 217 F.3d 899 (7th Cir. 2000).

⁷⁹ To date, the author has settled three TILA cases and two mortgage rescue fraud cases in his role as chapter 7 Trustee. Numerous TILA, HOEPA and mortgage rescue fraud cases remain pending.

⁸⁰ *In re Stratton (Sticka v. Geller)* 299 B.R. 616 (Bankr. D. Or. 2003).

⁸¹ 211 F.3d 1265 (4th Cir. 2000).

⁸² *In re Ball*, 201 BR 210 (Bankr. ND Ill. 1996).

⁸³ Compare *In re Stroble* No.03-24926-7 (Bankr. D. Kan. Sept. 7, 2005) (Berger, J.) with *In re Ross*, No. 05-42544 (Bankr. D. Kan. Feb. 10, 2006).

⁸⁴ *In Re Rodrigues* 278 B.R. 683 (Bkrcty.D. R.I. 2002).

⁸⁵ 15 U.S.C. § 1639(c)(1)(A).

⁸⁶ Debtor's attorney in *Rodrigues*, Christopher Lefebvre, is well known in consumer advocacy circles for pursuing TILA claims in the Bankruptcy Court. A similar case in Chicago, brought by David Yen of the Legal Assistance Foundation of Chicago on behalf of the debtor, *In re Bumpers* 2003 WL 22119929 (N.D. Ill.) reversed the bankruptcy court summary judgment in favor of the lender. The court held debtor should have had the opportunity to rebut the presumption that she received two copies of the rescission notice, whereas the bankruptcy court held, erroneously that the presumption was irrebuttable.

⁸⁷ Case No. 93-19652-JNF, Adv. P. No. 94-1008 (Bankr. D. Mass Jan. 24, 1995).

⁸⁸ *Myers v. Federal Home Loan Mortgage Co. (In re Myers)*, 175 Bankr. 122 (Bankr. D. Mass. 1994); but see *Ray v. Citifinancial, Inc.*, 228 F.Supp.2d 664 (D.Md. Oct 28, 2002) and cases cited therein.

⁸⁹ 329 B.R. 727 (D. Kan. 2005); see also *Merriman v. Beneficial Mortgage Co. of Kansas, Inc.*, 329 B.R. 710 (D.Kan.2005); *Webster v. Centex Home Equity Corp.* 300 B.R. 787 (Bankr. D. OK 2003); *In re Hopkins*, 372 BR 734 (Bankr. E.D. Pa. 2007) (discussing TILA in detail as well as RESPA and related claims, pleading standards, rebuttable presumption and other issues, denying motion to dismiss.); *In re Madel (Madel v. GMAC Mortgage Corp.)* 2004 WL 4055247 (Bkrcty .E.D. Wis.) (addressing assignee liability, rescission standards, RESPA claims and TILA standards generally).

⁹⁰ The *Rooker-Feldman* doctrine acquired its name from two Supreme Court cases, *Rooker v. Fidelity Trust Co.*, 263 U.S. 413 (1923) and *District of Columbia Court of Appeals v. Feldman*, 460 U.S. 462 (1983).

⁹¹ E.g. *In re Cooley (Cooley v. Wachovia Mortgage Corporation)* 365 B.R. 464 (Bankr. E.D. Pa. 2007); *Madera v. Ameriquest Mortgage Co. (In re Madera)*, 363 B.R. 718, 723-726 (Bankr.E.D.Pa.2007) (Sigmund, J.) (TILA); *Randall v. Bank One National Association (In re Randall)*, 358 B.R. 145, 152-163 (Bankr.E.D.Pa.2006) (Fox, J.) (TILA); *Faust v. Deutsche Bank National Trust Company (In re Faust)*, 353 B.R. 94, 100 (Bankr.E.D.Pa.2006) (Raslavich, J.) (the Unfair Trade Practices and Consumer Protection Law, 73 P.S. § 201-1 et seq.)

⁹² 544 U.S. 280 (2005).

⁹³ No. 06 A 683 (Bankr. ND. II. October 4, 2006). The opinion is available online at www.ilnb.uscourts.gov at Judge Goldgar's Opinions page.

⁹⁴ *In re Ferrell* 358 B.R. 777, (9th Cir. BAP (Nev.),2006)

⁹⁵ Compare *In re Lucas, (McDonald v. Cash N. Advance, Inc)*, 312 B.R. 407 (Bankr. D. Nev. 2004) (core proceeding where Chapter 13 trustee files claim against creditor for purposes of objecting to it) with *In re Derienzo (Schwab v. Sears, Roebuck and Co.)*,254 B.R. 334 (Bankr. M.D. Pa) ; *In re Rozell*, 357 B.R. 638 (Bankr.N.D.Ala. 2006) (non core).

⁹⁶ 15 U.S.C. §§ 1602(aa) and 1639.

⁹⁷ See Keyfetz, L. *The Home Ownership And Equity Protection Act Of 1994: Extending Liability For Predatory Subprime Loans To Secondary Mortgage Market Participants* 18 LOY. CONSUMER L. REV. 151 (2005). Ms. Keyfetz' 2005 article was particularly prescient as it describes the excesses and incentives for unscrupulous mortgage originators to steer unsuspecting borrowers into subprime loans. It should not be particularly surprising how many subprime borrowers now find themselves facing foreclosure and bankruptcy as a result. It is also not surprising how many subprime lenders also are in bankruptcy.

⁹⁸ *Moore v. Cycon* 2007 WL 475202 (W.D.Mich 2007).

⁹⁹ Somers, P. *Unfair and Deceptive Acts and Practices Statutes as a Mechanism for State Attorneys General to use to Combat Predatory Lending* available at http://www.law.columbia.edu/center_program/ag/Library/AG_Std_Papers?exclusive=filemgr.download&file_id=942541&rtcontentdisposition=filename%3DSomers-Unfair+and+Deceptive+Acts+and+Practices.pdf

¹⁰⁰ Brown, A, Hepler, L. *Comparison of Consumer Fraud Statutes Across the Fifty States* 55 FED'N DEF. & CORP. COUNS.Q. (Spring 2005) <http://www.thefederation.org/documents/Vol55No3.pdf>

¹⁰¹ A full chronicle of this phenomenon appears in, *Dreams Foreclosed: The Rampant Theft of America's Homes Through Equity-Stripping "Foreclosure Rescue" Scams*, NATIONAL CONSUMER LAW CENTER (2005), available at: www.nclc.org/news/content/ForeclosureReportFinal.pdf

¹⁰² *Moore v. Cycon* 2007 WL 475202 (W.D.Mich 2007.)

¹⁰³ See generally Johnson, C., *Stealing The American Dream: Can Foreclosure-Rescue Companies Circumvent New Laws Designed To Protect Homeowners From Equity Theft?* 2007 WIS. L. REV. 649

¹⁰⁴ <http://homeequitytheft-cases-articles.blogspot.com>

¹⁰⁵ 354 B.R. 331, 2006 U.S. Dist. LEXIS 82416 (D. Mass. 2006); *but see In re Holland*, 374 B.R. 409 (Bankr.D.Mass., 2007).

¹⁰⁶ 12 U.S.C. § 2606.

¹⁰⁷ Porter, K, *Misbehavior and Mistake in Bankruptcy Mortgage Claims*, UNIVERSITY OF IOWA LEGAL STUDIES RESEARCH PAPER NUMBER 07-29 (November, 2007).