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Borrower class actions increase since subprime crisis: So where are we after 1st quarter 2008?

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The recent Navigant Consulting study of federal court disputes resulting from the subprime mortgage crisis, based on analysis of 278 cases filed during 2007, identified borrower-filed class actions as the largest component (43 percent). All 10 of the top subprime lenders in 2006 faced borrower class action claims during 2007.

Navigant also predicted that the rate of such court filings would increase in 2008 and quickly surpass the total of 559 Resolution Trust Corp. litigation disputes caused by the savings & loan crisis of the 1980s. (*See March 19 issue, p. 11.*) Because a recessionary economy drives an increase in litigation, 2008 is certain to be a bumpy ride.

Princeton economist Paul Krugman predicts that the U.S. housing market and the economy will worsen throughout 2008 and may take until 2011 to recover. Krugman also predicts that home prices will continue to fall until about 20 million people — 25 percent of all homeowners — are in a position of having negative equity in their home. (*See "How Bad Is the Mortgage Crisis Going to Get?" Fortune, March 2008.*)

Only a fraction of that projected decline has happened so far. Krugman and others now predict the losses on mortgage-backed securities paper will be closer to \$1 trillion instead of the \$500 billion loss predictions made by others. That's a scary forecast. Now that we are at the end of the first quarter, let's take a look at some of these borrower class action cases filed most recently, as a barometer of the litigation squalls ahead for the mortgage industry.

The big picture: 6 points

I analyzed the complaints in 35 borrower class actions filed from June 2007 until the end of February 2008. When focusing on the dozen class actions filed in 2008 (*see table on page 4*), some new trends appear:

- 1) The volume of borrower class action claims has been escalating.
- 2) The Class Action Fairness Act is increasingly being used to either bring these types of borrower class actions in federal court or for removal jurisdiction.

3) Nationwide classes are being attempted about as often as single state classes. Fifty percent of the dozen newest class claims seek certification of nationwide classes.

4) All major mortgage industry players are getting sued — Countrywide, Bank of America, Washington Mutual, Homecomings, EMC Mortgage, Wells Fargo, and Wachovia. No one will be immune from this strengthening storm of borrower litigation.

5) The cases are being filed not just in New York, Pennsylvania and California. The plaintiff's lawyers bringing these claims are filing all over — Florida, Delaware, Connecticut, Ohio, Minnesota, Missouri and Washington are in the game.

6) These litigation challenges are still in the early phases, and no classes have been certified in any of the borrower class cases filed after June 2007. It will take most of this year to see whether plaintiffs will be more successful getting classes certified in the current market conditions as compared to times before the 2007 stresses arose.

Servicing abuse claims proliferate

At the forefront of the borrower class action claim storm are cases alleging various forms of illegal or predatory conduct in the loan servicing process. Half of the 2008 cases attacked servicing practices.

For example:

■ The *Pardo v. Countrywide* case filed in a Florida federal court as an adversary proceeding in bankruptcy attempts a nationwide class of borrowers allegedly charged excessive or unapproved fees via lender claims in Chapter 13 proceedings. They assert claims for violation of the bankruptcy stay and for disregard of confirmed plans/discharge orders. Countrywide faces a similar nationwide class claim filed in Delaware federal court by Gregory O'Gara, claiming breach of contract and unjust enrichment with respect to servicing abuses.

■ In *Motley v. Homecomings Financial*, GMAC-ResCap is defending a putative nationwide class of bor-

rowers challenging late fees, default-related fees, property inspection fees, forced place insurance charges, and payment processing fees. TILA, FDCPA and UDAP claims are added to the mix in the Minnesota battle.

■ In *Rodriguez v. Bear Stearns/EMC Mortgage*, the servicing abuse claims come with the spin of a nationwide class of black and Hispanic borrowers alleging disparate impact race discrimination by EMC servicing/collection policies and practices in violation of the Fair Housing Act and the Civil Rights Act. Expect to see servicing abuse claims skyrocket in 2008 as delinquencies increase, foreclosure battles accelerate, and bankruptcies rise.

More fiduciary duty claims/unsuitable loan cases

Emboldened by new state laws that impose fiduciary duties and/or agency duties on mortgage brokers, more class action filings allege that unsuitable loans were made by unscrupulous brokers and/or lenders acting in concert.

In *Bales v. Countrywide*, the allegations are that the broker steered borrowers into higher cost loans that were inappropriate, and claims are asserted for constructive fraud, civil conspiracy, and violation of the Missouri UDAP statute. Expect to see borrower class actions arise in any states that impose fiduciary duty obligations on all brokers and/or mortgage lenders — Illinois, Maine and Minnesota have already passed statutes and several other states may do so as well.

Appraisals, disclosures and fees attacked

The other types of recurring claims include attacks on appraisal manipulations, inadequate disclosures concerning adjustable rate mortgage products with payment options or rate resets, hidden mark ups, fees in-

cident to mortgage refinance/recording updates, and prepayment penalties/due-on-sale clauses.

How hostile will the courts be?

The biggest uncertainty risk for lenders is the negative public opinion and press and the charged political environment surrounding the mortgage market meltdown. Without question, the class action complaints being filed are laced with citations to articles, consumer studies, regulatory pronouncements, public hearings, and all sorts of inflammatory data — with the goal of influencing the contextual mindset of the federal judges who will be asked to make rulings on the appropriateness of these cases for class aggregation.

When these cases come on for Rule 23 certification hearings in mid to late 2008 — when rate resets and default problems are predicted to be at their peak frenzy, and when judges are holding these hearings in Arizona, Nevada, Ohio, Michigan, California, Florida and other areas hardest hit by the bursting of the housing bubble — then we should not be surprised to see some increased class certification success.

Settlements might not be the end

Finally, although some of these borrower class actions might be settled between the litigants, this does not ensure that all storms have passed. The CAFA-required pre-notification to primary regulators and to states' attorneys general might trigger other consequences in the current unsettled climate. You never know when such settlement notices will draw the ire of a regulator with an independent agenda for headlines.

Fasten all seat belts, there's serious turbulence ahead. □