ALSTON+BIRD LLP

Class Action ADVISORY

September 24, 2009

HELOC Reduction Litigation: The Northern District of California Issues First Order that TILA, UDAP, Contract Claims Are Sufficiently Pled

In 2009, there have been at least eight separate federal court class actions filed against financial institutions for unilaterally reducing borrowers' Home Equity Lines of Credit (HELOCs) based upon a belief that there was a significant decline in the value of the collateral since the opening of the line of credit.

The Truth in Lending Act (TILA) allows for banks to reduce lines of credit, but only if there is strong support that there has been a "significant decline" in collateral value, which Reg Z has interpreted to mean at least a 50 percent evaporation in the amount of equity the borrower had in the house at the time the loan/equity line was established. Written notice of the action within three days of a line being reduced and an appeals process for the borrower are also required. Automated Valuation Models (AVMs) are permissible for banks to rely upon to demonstrate the drop in home value/collateral, rather than full appraisals, but if AVMs are used, they have to be reasonable and must be periodically audited/scrubbed for accuracy.

The **linked article**, which was published in the *Consumer Financial Services Law Report* last month, discusses this claim trend and references several of the initial cases.

These types of class action claims are increasing in number. They have now been filed in California and Illinois and there are, as seen just recently with the *Winkler* case, two separate plaintiff coalitions of firms filing them—so far.

Levin, et al. v. CitiBank, N.A., USDC, NDCA., Oakland Div. (Case No.: 3:09-cv-00350-MMC)

Kimball, et al. v. Washington Mutual Bank, et al., USDC, SDCA (Case No.: 09-cv-1261-BEN)

Schulken, et al. v. Washington Mutual Bank, et al., USDC, NCCA (Case No.: 5:09-cv-02708-HRL)

Walsh, et al. v. Washington Mutual Bank, et al., USDC, CDCA, Southern Div. (Case No.: 2:09-cv-04387-RGK-AN)

Wilder, et al. v. JPMorgan Chase Bank, N.A., et al., USDC, CDCA (Case No.: SACV09-834 DOC)

Hickman, et al. v. Wells Fargo Bank N.A., USDC, NDIL (Case No.: 1:09-cv-05090)

Majon, et al. v. Washington Mutual Bank, et al., USDC, NDIL (Case No.: 1:09-cv-05118)

Winkler v. CitiGroup Inc., et al., USDC, SDCA (Case No.: 09-cv-1999-BTM)

All of the matters are in the early stages. The oldest of the cases, *Levin v. Citibank*, is the first to rule upon a motion to dismiss.

The **linked opinion** is the initial determination by a court concerning the potential viability of class action claims against lenders for reducing home equity lines of credit in the face of falling housing prices—allegedly without legal justification for the credit contraction.

Nearly nine months after the *Levin v. Citibank* lawsuit was filed, District Court Judge Maxine M. Chesney from the NDCA ruled on September 17 that claims for violation of TILA, for breach of contract and for deceptive practices under California Section 17200, are sufficiently pled to survive a Rule 12(b)(6) motion to dismiss.

The *Levin* case will proceed to discovery, and unless discovery produces evidence that no material fact issue is created under the TILA procedures for credit reductions, then the matter will progress toward an eventual class certification determination. The other federal cases, which have been filed against lenders such as JP Morgan Chase, Washington Mutual and Wells Fargo, contain similar core claims as *Levin*, and can also be expected to survive motions to dismiss as a matter of law.

There are a number of uncertainties under the TILA regulations which will be vetted in these cases, including issues such as the following:

- Does the TILA "significant decline" in property value standard have to be analyzed by banks on an individual collateral property basis, or can it be analyzed at first cut—i.e., the initial reduction—on a purely geographic basis?
- What type of testing of the AVM process is required in order to establish that the AVMs being used are accurate, and that their use is reasonable in this context?
- If asked by borrowers, do banks have to disclose their AVM testing procedures and results?
- If requested by the borrower, subject to a reduction, is the bank required to disclose to the borrower the value their home needs to appraise for in order for the HELOC to be reinstated?
- If the borrower, subject to a line reduction, decides to transfer the HELOC to another bank, is it permissible for the line-reducing bank to charge the borrower an Early Termination Fee (ETF)?
- For reduced HELOC lines that carry an annual maintenance fee charge, after a line is reduced, must the bank refund to the borrower a proportional amount of the annual fee that corresponds to the size of the line reduction?

- If the bank that reduces a HELOC charges the borrower any NSF fees for dishonored drafts/checks or overdraft of the reduced line, must/should the bank refund these NSF fees to the borrower?
- What is a sufficient notice to the borrowers of a reduction in the HELOC line and what is a reasonable appeal process for borrowers? Particularly, if a borrower obtains an appraisal that refutes the bank's AVM figure, is the bank required to reinstate, and if it does reinstate, must/should the borrower be reimbursed the costs for the new protest appraisal?
- What written notice process, "within three days," will pass muster under Reg Z, and if the timing aspect of the notice is invalid (delivered late or not delivered at all), and yet the significant reduction in the property value is solidly documented, what is the borrower entitled to as a result of the missed notice—reinstatement of the line, damages in some form or nothing?
- Under the principal claim theories of TILA violation, breach of contract and deceptive business practices, can any of these cases satisfy the Rule 23 elements for certification of a declaratory judgment/injunction class, and what about the elements for a damages class—including a "predominance" of common issues over individual ones and the "superiority" of the case handled in the aggregate fashion?

There are multiple compliance and litigation issues to pay attention to as a result of these cases. For example, the scope of the self-evaluative privilege may come into play as a result of AVM testing. Stay tuned for lots more action in this arena.

ALSTON+BIRD LLP

If you would like to receive future *Class Action Advisories* electronically, please forward your contact information including e-mail address to **classaction.advisory@alston.com**. Be sure to put "**subscribe**" in the subject line.

If you have any questions or would like additional information please contact your Alston & Bird attorney or one of the following:

Frank A. Hirsch, Jr.
frank.hirsch@alston.com
919.862.2278

Cari K. Dawson
cari.dawson@alston.com
404.881.7766

Lloyd M. Winans
lloyd.winans@alston.com
212.210.9435

Jeffrey L. Hare
jeffrey.hare@alston.com
202.239.3902

ATLANTA
One Atlantic Center
1201 West Peachtree Street
Atlanta, GA 30309-3424
404.881.7000

CHARLOTTE
Bank of America Plaza
Suite 4000
101 South Tryon Street
Charlotte, NC 28280-4000
704.444.1000

DALLAS
Chase Tower
Suite 3601
2200 Ross Avenue
Dallas, TX 75201
214.922.3400

LOS ANGELES
333 South Hope Street
16th Floor
Los Angeles, CA 90071-3004
213.576.1000

NEW YORK
90 Park Avenue
New York, NY 10016-1387
212.210.9400

RESEARCH TRIANGLE
Suite 600
3201 Beechleaf Court
Raleigh, NC 27604-1062
919.862.2200

SILICON VALLEY
Two Palo Alto Square
Suite 400
3000 El Camino Real
Palo Alto, CA 94306-2112
650.838.2000

VENTURA COUNTY
Suite 215
2801 Townsgate Road
Westlake Village, CA 91361
805.497.9474

WASHINGTON, D.C.
The Atlantic Building
950 F Street, NW
Washington, DC 20004-1404
202.756.3300

www.alston.com