GUEST COMMENTARY

SCOTUS QUESTIONS TILA RESCISSION RIGHTS

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The United States Supreme Court recently heard oral arguments in the much-debated case of *Jesinoski v. Countrywide Home Loans Inc.*, No. 13-684 (U.S., *argued* 11/04/14), concerning rights to rescind a loan granted by the Truth in Lending Act. Justice Stephen G. Breyer presented the zinger observation during the arguments — noting that the statutory language was so clear that mere notice triggered the rescission right that it is Houdini-esque to try and twist the statute into a different conclusion.

Maybe so, but a majority of the U.S. Circuit Courts of Appeals that have considered the issue have performed that trick and held that Congress never intended to abrogate hundreds of years of remedies law concerning the process of rescinding a deal when it specified a notice requirement in TILA if a borrower wants to unwind a loan transaction.

Let's take a look under the hat at the issues and the recent oral argument and see if we can discover the probable ruling and the possible consequences.

THE MAGIC OF TILA RESCISSION

Congress passed TILA in 1968 "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 . . . practices." (15 U.S.C. § 1601(a).) TILA and its accompanying implementing Regulation Z only apply to certain consumer transactions secured by a borrower's primary residence.

Perhaps the most powerful tool for consumers in TILA is the right of rescission, which provides a three-day cooling off period during which the consumer can cancel the loan without penalty. Because this three-day cooling off period is calculated from the date of certain disclosures required by the statute, TILA as initially drafted could provide rescission many years after the closing of the loan so long as the required disclosures were never made. However, recognizing that rescission is the most draconian of remedies, Congress amended TILA in 1974 to provide a three-year cap on the right of rescission, calculated from the date of closing.

This amendment, which lies at the heart of the question presented in *Jesinoski*, provides that a borrower's "right of rescission shall expire three years after the date of consummation of the transaction . . . notwithstanding the fact that the information . . . required under this section or any other disclosures required under [the Act] have not been delivered to the [borrower]." (15 U.S.C. § 1635(f).)

The question at issue in *Jesinsoski* is whether a borrower has acted within the three-year period provided by 1635(f) when it merely provides its creditor with notice of its intent to rescind. What if the creditor disputes that the disclosures were inadequate and opposes the borrower's ability to rescind — does the borrower have to also actually file a lawsuit seeking rescission within the three-year period? The petitioners, the Jesinowskis, and the Consumer Financial Protection Bureau argued that mere notice is sufficient. The respondent, Bank of America, argued that the filing of a lawsuit is required.

THE CIRCUIT PROPHECY

Jesinoski arose on appeal from the 8th U.S. Circuit Court of Appeals. The Minnesota borrowers had provided their creditors with a notice of their intent to rescind within three years of the closing of their loan, but they failed to bring their actual suit for rescission until over four years after closing. The 8th Circuit affirmed the district court's dismissal of the borrower's claim (*Jesinoski v. Countrywide Home Loans Inc.*, 729 F. 3d 1092 (8th Cir. 2013).) In doing so, the 8th Circuit agreed with the prior divination of the 9th, 10th, and 6th Circuits, and arguably also the 1st Circuit. (*McOmie-Gray v. Bank of Am. Home Loans*, 667 F.3d 1325 (9th Cir. 2012); *Rosenfield v. HSBC Bank, USA*, 681 F.3d 1172 (10th Cir. 2012); *Lumpkin v. Deutsche Bank Nat'l Trust Co.*, 534 F. App'x 335 (6th Cir. 2013); *Large v. Conseco Fin. Serv. Corp.*, 292 F.3d 49 (1st Cir. 2002).)

On the opposite side of the conjure, the 3d and 4th Circuits, and to a lesser extent the 11th Circuit, have held that the only step a borrower needs to take within the three-year period provided by 1635(f) is to give the creditor notice of their intent to rescind. (*Sherzer v. Homestar Mortg. Servs.*, 707 F.3d 255 (3d Cir. 2013); *Gilbert v. Residential Funding LLC*, 678 F.3d 271 (4th Cir. 2012); *Williams v. Homestake Mortg. Co.*, 968 F.2d 1137 (11th Cir. 1992).) The justices of the Supreme Court will soon be the sirens that solves the issue.

THE ARGUMENTS OF THE SHAMAN

The Jesinoskis and the CFPB as *amicus curiae* argued that both the plain text and the structure of § 1635 mandate a reversal. Section 1635(a) provides that "the obligor shall have the right to rescind . . . by notifying the creditor, in accordance with regula-

tions of the Bureau, of his intention to do so." Regulation Z provides that, "[t]o exercise the right to rescind, the consumer shall notify the creditor of the rescission by mail, telegram or other means of written communication. Notice is considered given when mailed, when filed for telegraphic transmission or, if sent by other means, when delivered to the creditor's designated place of business." (12 C.F.R. § 226.23(a)(2).)

Although the Jesinoskis acknowledge that § 1635(f) places an outer limit on the period of time within which the borrower may rescind a covered transaction (three years from closing), they insist that rescission is effective immediately upon the giving of notice. They bolster their conclusion by arguing that § 1635(f) says nothing about how the rescission right is exercised and it does not establish a time limit for the filing of suit in court to enforce the legal effect of a valid notice of rescission. They escape the import of the several references to court involvement in § 1635 as mere references to lawsuits in which the courts must decide whether the lender has already rescinded the transaction — not a reference to lawsuits to effect a rescission.

With the opposite prestidigitation, BofA and its industry *amici* emphasized the impact of § 1635(f), and that the Court's decision in *Beach v. Ocwen Fed. Bank*, 523 U.S. 410 (1998) mandated an affirmation of the majority view of the circuit courts. Specifically, they argued that *Beach* acknowledged that in adding § 1635(f), Congress expressed its "manifest intent" to "completely extinguish[] the right of rescission at the end of the 3-year period." They proclaimed that *Beach* interprets § 1635(f) as a statute of repose: " [it]takes us beyond any question whether it limits more than the time for bringing suit, by governing the life of the underlying right as well."

The bank distinguished between a notice of rescission made within the three-day period following closing, which is unconditional and automatic, and a notice provided after the three-day period, which is merely notice of an intent to rescind, and is ineffective until it is decided that the condition precedent to rescission (improper disclosures) was met. The bank and the finance industry also emphasized the practical concerns associated with CFPB's position, by interjecting further risk and uncertainty into the already skittish lending markets.

The *presto* effect of rescission notice would establish a procedure allowing a borrower to relegate its creditor to unsecured status without a tender of loan proceeds. Such abracadabra would also allow a borrower to enforce a rescission for an undefined period after the three-year term, so long as notice was provided within three years of closing.

THE ILLUSIONISTS AT ORAL ARGUMENT

Oral arguments were made by David Frederick of Kellogg Huber Hansen Todd Evans & Figel in Washington, D.C., on behalf of the Jesinoskis; Elaine Goldenberg, assistant to the Solicitor General, on behalf of the United States/CFPB as *amicus*; and Seth P. Waxman of Wilmer Cutler Pickering Hale & Dorr in Washington, D.C., on behalf of Bank of America. The presentations were spirited and the Justices appeared to enjoy themselves by making jokes a couple of times which drew laughter.

Justices Antonin G. Scalia and Samuel A. Alito Jr. asked questions which expressed the most skepticism of the Jesinoskis' wizardry.

Justice Scalia appeared disturbed by a rescission procedure wherein "immediately the secured interest is converted into an unsecured interest." (Poof and hocus-pocus come to mind). He found such a procedure even more concerning where, unlike the common law procedure for rescission, tender was not required to be immediately made.

Justice Alito was likewise concerned with what happens in the scenario where a rescission is already completed upon notice, but where the borrower is then unable to tender. Making perhaps the second most notable reference to illusionist practices, he asked Frederick whether thereafter "the rescission is rescinded?" When the attorney pointed out that § 1635(b) provides that the procedure for rescission may be altered by court order, Justice Alito responded that "[y]ou're reading an awful lot into that section."

Although other Justices also asked questions of Frederick, they were generally in the vein of seeking confirmation of their prior understandings rather than expressions of doubt towards the arguments. Justice Elina Kagan expressed her frustration with the role of fortune-telling through an opaque crystal ball:

"Congress couldn't have thought that every time there was a notification, the lender was going to agree with the borrower that it was appropriate. Congress must have thought that there were going to be some cases where the lender and the borrower disagreed, and yet Congress didn't say anything about how those cases would be resolved and that's a puzzling feature of this statute."

Frederick had to admit that "I can't deny that."

Goldenberg's oral argument for the federal *amici* proceeded similarly, with the only real challenge coming from Justice Alito, who questioned her regarding the unenviable position of a lender who has received a notice of rescission, but who doubts the validity of the notice.

The most difficult scrutiny from the bench was saved for Waxman. Chief Justice Roberts and Justices Anthony M. Kennedy, Ruth B. Ginsburg, Sonia Sotomayor, and Breyer all asked questions that appeared to express doubts regarding the bank's position. For example:

- Ginsburg: "This isn't at common-law. This is a statute and [§ 1635] (b) describes how rescission works under this statute."
- Roberts: "You're putting an awful lot of weight on a tiny, one-sentence provision in [§ 1635] (g) that's called "additional relief," that — I think — would be very odd if that's where Congress decided to place the provision that tells you what ... happens when there's exercise of the right to rescind."
- Sotomayor: "You don't get a rescission just by filing a lawsuit either [implying 3- year statute of repose is extended by the life of any lawsuit filed]. So, under your theory, the right of rescission has to be the award. You can't guarantee that a court is going to act in three years."

In particular, the Justices seemed unaccepting of the subtle contention that the exercise of the right of rescission, if completed by giving notice, is still different than actually obtaining rescission, which requires a lawsuit.

Justice Thomas, as usual, asked no questions.

POTENTIAL REVERSAL RAMIFICATIONS

If the tone and content of the questioning at oral argument is an accurate indication of the Court's inclination, the outlook appears adverse for mortgage lenders, servicers, and participants in the residential mortgage market. But questioning from the bench is not a ruling, and we must await the ruling and the written opinion to know whether magic awaits and the Court follows the lead of the majority of Circuit Courts.

Should the SCOTUS ultimately find that mere notice of an intent to rescind effectuates a rescission, these parties will be confronted with a host of challenges.

- First, a ruling for the Jesinoskis' position will increase litigation costs by compelling lenders and/or servicers to file suit upon receipt of all notices of rescission, no matter how baseless. TILA provides that when a rescission is had, the lender must pay back to the borrower all interest payments and fees paid to date. Thus, if there is any potential that the borrower's notice has validity, the lender is confronted with a Hobson's choice of risking an interest-free loan and bringing a suit for a declaratory judgment stating that the borrower lacks the right to rescind.

Furthermore, if, as the Jesinoskis argue, rescission is had upon mere notice, a foreclosing party in a nonjudicial foreclosure state will be forced to litigate the effectiveness of the borrower's notice before proceeding to foreclosure, lest they risk a wrongful foreclosure suit or the setting aside of the foreclosure sale. In addition to a marked increase in litigation, this would also frustrate the carefully thought out procedures created by state legislatures by moving foreclosures in non-judicial foreclosure states back into the judicial pipeline.

The increased expense and burden associated with claims for rescission that a ruling for the Jesinoskis will inevitably create also raises the question of whether courts will begin to recognize claims for bad faith notices of rescission.

- Second, a ruling for the Jesinoskis would require that courts make a determination as to the most analogous statute of limitations for purposes of a suit to enforce a rescission. On the facts of this case, if notice was effective, then a Minnesota borrower's subsequent suit to enforce that rescission could be subject to Minnesota's six-year statute of limitations. That's unwinding a mortgage transaction up to nine years after the closing. Thus, a ruling adverse to the banking industry has the potential to create a legal landscape whereby a borrower's ability to enforce a rescission is dependent upon where the property is located — creating additional uncertainty in the mortgage market.
- Third, the Jesinoskis' argument that rescission is effective immediately upon the giving of a notice of intent to rescind likewise changes a creditor's status from secured to unsecured immediately upon the giving of notice. Thus, when a creditor receives a notice of intent to rescind, but cannot come to a 100 percent conclusion regarding its validity, it cannot be sure as to whether or not its security interest in the underlying property remains.

While this secured-creditor limbo is problematic for all creditors, it is particularly problematic for participants in the residential mortgage-backed securities market. For example, most RMBS transactions involve representations and warranties regarding the status of the lien on the property. If, as the Jesinoskis argue, a creditor's security interest is removed at the time of notice, all loans for which a notice was received by a servicer are, might be, in effect, un-securitizable no matter how frivolous the notice of rescission appears to have been.

Also, where a notice of intent to rescind is received for an already-securitized loan, even where there are

significant doubts about its validity, an RMBS trustee is confronted with a choice of executing an expensive loan repurchase or risking future suit by investors should the rescission subsequently be found to have been effective. Thus, a win for the Jesinoskis would require participants in the RMBS market to create effective work-arounds for such loans.

POTENTIAL IMPORT OF AFFIRMING THE CIRCUIT MAJORITY

Should the Court ultimately agree with the skepticism expressed by Justices Scalia and Alito, the burdens associated with obtaining a rescission would shift to borrowers. Specifically, the burden will be placed on borrowers to file suit within three years of closing and they may not rely on their notice of intent to rescind to preserve their right of rescission. Accordingly, if a borrower has asserted a rescission and its creditor has not responded, or has responded by denying rescission, a borrower must bring suit. Such a procedure could encourage creditors to sit on their hands in the hopes that the borrowers fail to bring suit within three years.

Regardless of how the Court ultimately decides the specific question at issue, the adversarial history of TILA rescission raises important questions. For example, should Congress amend Section 1635 to change the rescission process? If so, how? While Congress might desire that the burden for filing suit be placed on creditors instead of borrowers, an amendment that provides that the rescission itself is not effected immediately upon notice would alleviate many of the tricky legal questions, including those which implicate the RMBS market.

The confusion surrounding the rescission process also raises another question: Should the Court find the rescission process void for vagueness? Indeed, Justice Kagan's expressed puzzlement with the statutory crafting of Congress could lead others to conclude this legislative construct is inscrutable and thus unenforceable.

We certainly don't know for sure whose slight- of – hand will win the day on this TILA issue, but the *Jesinoski* case raises some big picture concerns. It has to make one wonder, for example:

- Why is a basic element of cost of this credit disclosure statute so unclear/uncertain now more than 40 years after it was enacted?
- If automatic rescission is accomplished upon notice according to TILA, then does that impermissibly tread upon the state court's role in controlling the mortgage foreclosure process or does it preempt state laws?
- Can the statutory interpretation of rescission in a lending context which is covered by TILA abrogate the state's common-law procedural requirements and preconditions for a rescission remedy?

And, finally, how long might it take these uncertainties to be resolved?