

State Attorneys General Strong-Arm Mortgage Lenders

By Shaun K. Ramey and Jennifer M. Miller

Unfair or deceptive acts or practices (UDAP) laws prohibit deceptive practices in consumer transactions and, in many states, also prohibit unfair or unconscionable practices. By broadly prohibiting deception, rather than confining the prohibition to a closed list of deceptive tactics, states like Massachusetts are able to attack consumer transactions in a variety of settings.¹ Recently, states' attorneys general have used the UDAP laws to halt foreclosures and to delay the selling or transferring of mortgages. How this is being done and whether such actions are appropriate is the focus of this article.²

Massachusetts Leads the Way

Massachusetts' UDAP statute has broad prohibitions and no significant exemptions. The law gives the Massachusetts AG the authority to adopt regulations defining unfair and deceptive acts, and the AG has adopted a number of strong, specific regulations. These regulations have been used to intervene in the foreclosure process. Specifically, the Massachusetts AG has recently utilized the state's UDAP statute as a vehicle to halt the foreclosure activities of certain lenders that are not owned by national banks and which do not have federal preemption arguments to avoid state regulatory enforcement.

The Massachusetts attorney general (AG) first filed suit against Fremont Investment & Loan in October 2007, seeking to enjoin it from foreclosing on loans that allegedly violated the state's UDAP law. In June 2008, the Massachusetts AG filed suit against Option One Mortgage Corp., using the state's UDAP as her legal vehicle to halt foreclosures initiated by Option One and H&R Block.³ The Massachusetts AG was successful in both cases. Since that time, on June 9, 2009, the Massachusetts AG's office announced its biggest victory—a \$10 million settlement with Fremont.⁴

The Fremont Case

In *Commonwealth v. Fremont Investment & Loan*, the Massachusetts Supreme Judicial Court affirmed the AG's use of the state's UDAP statute to enjoin Fremont from foreclosing on any of its loans that were deemed to be "presumptively unfair" or unsuitable without prior written approval from the AG.⁵ The injunction was sought after the lender and the Commonwealth had entered into an

agreement whereby they consented to a notice and objection process for all foreclosures that the lender might seek to initiate. This agreement was reached after Fremont had entered into a consent agreement with the Federal Deposit Insurance Corporation (FDIC) over the lender's allegedly unsound origination practices. The loans in question contained the following four characteristics:

- (1) An adjustable rate mortgage with an introductory rate period of three years or less;
- (2) An introductory/teaser rate for the initial period that is 3 percent below the fully indexed rate;
- (3) The borrower's debt-to-income ratio exceeded 50 percent when measured by the fully indexed rate (rather than the introductory/teaser rate); and
- (4) The loan-to-value ratio was 100 percent or the loan carried a substantial prepayment penalty or a prepayment penalty that extended beyond the introductory period.⁶

In so holding, the Supreme Judicial Court claimed that Massachusetts's UDAP creates new substantive rights, and in particular cases, "makes conduct unlawful which was not unlawful under the common law or any prior statute."⁷ Central to the court's analysis was the fact that violations of the Massachusetts Predatory Home Loan Practices Act also constituted unfair trade practices.⁸

Despite the aforementioned loan characteristics, however, both the lower court and the Supreme Judicial Court admitted that the loans in question were not, by definition, "high cost mortgage loans" prohibited by the Massachusetts Predatory Home Loan Practices Act.⁹ Consequently, the lender claimed that it could not be held liable because there was no state or federal law prohibiting the lender from originating loans with the features at issue. The Supreme Judicial Court disagreed, stating that the conduct sought to be prohibited by the Massachusetts Predatory Home Loan Practices Act was similar to the lender's practices whether explicitly covered by that act or not. The court stated that "when [the lender] chose to combine in a subprime loan the four characteristics . . . [the lender] knew or should have known that they would operate in concert essentially to guarantee that the borrower would be unable to pay and default would follow."¹⁰

The Supreme Judicial Court further noted that although these loans were not explicitly prohibited by the Massachusetts Predatory Home Loan Practices Act, that did not mean the loans were acceptable. “That the Legislature chose in the act to focus specifically on home loan mortgages with different terms and features . . . is not dispositive; the question is whether the act may be read to establish a concept of fairness that may apply in similar contexts.”¹¹ The court reasoned that the Massachusetts Predatory Home Loan Practices Act was merely “an established, statutory expression of public policy that it is unfair for a lender to make a home mortgage loan secured by the borrower’s principal residence in circumstances where the lender does not reasonably believe that the borrower will be able to make the scheduled payments and avoid foreclosure.”¹² Similar conduct, reasoned the court, whether explicitly covered or not, could constitute a violation of Massachusetts’ UDAP law. In fact, noted the court, the lender had cited no state or federal authority that permitted the combination of the loan characteristics at the time the loans were originated. Consequently, the court essentially found that it was the lender’s burden to establish that the loans did not violate Massachusetts’ UDAP law rather than the AG’s burden to establish that the lender had violated a specific law and, thus, violated the UDAP law.

Even assuming liability could stand for conduct that was not expressly prohibited by the Massachusetts Predatory Home Loan Practices Act (i.e., because that act only applied to high-cost loans), the lender argued that imposing liability would be a retroactive application of the law at best. The lender argued that its conduct should be viewed under the mortgage industry standards at the time the loans were made, as opposed to current standards. Once again, the Supreme Judicial Court disagreed, holding that originating loans with this combination of features was “within established concepts of unfairness at the time the loans were made and thus in violation of §93A.”¹³ The court further pointed to the lender’s consent agreement with the FDIC. While the court stated that the agreement contained no admission of wrongdoing and, thus, it would not consider the agreement as evidence of liability on the lender’s part, the court noted that the agreement indicated that the FDIC considered the lender’s conduct to violate established mortgage lending standards.

Fremont Expanded: Commonwealth v. Option One Mortgage

In June 2008, the Massachusetts AG brought a similar action under the same UDAP provision against Option One Mortgage Corp. and H&R Block.¹⁴ The *Fremont* court granted the AG’s request for a preliminary injunction against Option

One and H&R Block’s foreclosures in the state due to its UDAP violations in the origination of the loans.

Specifically, the AG sought a preliminary injunction seeking to prevent the servicers from selling, transferring, or foreclosing “on any property secured by a Massachusetts loan issued by Option One or H&R Block without first giving the AG a 90-day period to examine the documentation on the loan.”¹⁵ The suit was initiated because the Massachusetts AG alleged that “Option One and H&R Mortgage had a Pricing Policy that was based, in part, on subjective factors under which black and Latino borrowers were charged higher points and fees than similarly-situated non-minority borrowers for loans in Massachusetts, even when objective factors other than race and national origin were equal.”¹⁶ Per the AG, Option One also allegedly engaged in unlawful servicing practices, such as failing to credit payments, demanding excessive fees to avoid foreclosure, and pressuring delinquent borrowers to enter unfair forbearance agreements. In response, Option One argued that it did not have fair notice that the conduct proscribed by the court in *Fremont* could be deemed unfair. The court disagreed, stating that Option One’s actions were “structurally unfair” and that the loans were such “that the borrower would likely be unable to repay and unable to refinance once the introductory period ended.”¹⁷ Furthermore, the court noted, “it would perhaps have been more accurate to characterize the prohibited unfair conduct as the issuance of home mortgage loans with reckless disregard of the risk of foreclosure.” Thus, the court made clear that “the policies that ignore the suitability of a subprime loan for certain consumers may be considered ‘unfair and deceptive’ even if the lender complies with other consumer protection laws and regulations.”¹⁸

The court noted, early in its decision, that when issuing subprime loans, the servicers should have recognized that the borrowers “would not be able to meet the scheduled payments once the low introductory rate, known colloquially as the ‘teaser’ rate, expired at the close of the introductory period; and would not be able to refinance the loan at or around the close of the introductory period if housing prices declined.”¹⁹ The court expanded its analysis from *Fremont* by deciding to “revise th[e] criterion by including all loans with an introductory or ‘teaser’ rate for the initial period that is at least 2 percent lower than the fully indexed rate, and will eliminate this criterion entirely for all loans with a debt-to-income ratio of 55 percent or above.”²⁰ Secondly, the court lowered the loan-to-value ratio in the fourth criterion from 100 percent, as established in *Fremont*, to 97 percent.²¹

Since *Fremont* and *Option One*, the Massachusetts AG has not initiated any similar suits at the time of this publication. It is likely, however, that these two cases will not

be that AG's last word. The expansion of Massachusetts' UDAP law and its retroactive application is adversely affecting servicers' ability to retain their security upon default in the state of Massachusetts. It is a powerful expansion (if not creation) of the law, which retroactively examines terms entered into between parties with a cynical view based on the current, hostile environment toward mortgage lenders. The actions of the Massachusetts AG set a dangerous precedent for other states' attorneys general to follow. Indeed, as discussed below, other states' attorneys general have begun to use their own UDAP statutes to strong-arm mortgage lenders into injunctive and monetary settlements.

Use of UDAP Statutes

Following Massachusetts' lead, other states have used their UDAP statutes to pressure lenders into settlements that are designed to protect their borrowers. The terms of settlement vary widely depending on the nature of the suit and the allegations in the initial complaint. Below, nevertheless, are four examples of settlements that have been obtained by states' attorneys general using the threat of the state UDAP statute:

Ohio v. New Century Financial Corp.

In *Ohio v. New Century Financial Corp.*,²² Ohio's AG brought suit against New Century Financial Corp. alleging, among other things, that New Century "committed unfair and deceptive acts and practices in violation of [Ohio's UDAP] by representing that the subject of a consumer transaction was being supplied in accordance with a previous representation when it was not."²³ As a result, the parties entered into an agreement including an injunction that permanently prevented New Century and its subsidiaries from:

- Soliciting Ohio consumers for broker services or residential mortgage loans; accepting fees from Ohio consumers in connection with residential mortgage loans, except fees disbursed by a closing agent after a loan is closed and funded;
- Accepting mortgage loan applications in Ohio;
- Initiating new foreclosure actions, continuing to prosecute pending foreclosure actions, enforcing foreclosure sale notices, or evicting consumers from houses in foreclosure, without prior approval from the state; or
- Transferring, selling, or assigning rights to any Ohio residential mortgage loan absent prior approval from the court.²⁴
- Per the settlement agreement, New Century was further required to pay \$200,000.

California v. Countrywide Financial Corp.

On October 20, 2008, Bank of America, which acquired Countrywide, settled claims brought by 11 state AGs against Countrywide for allegedly engaging in unfair and deceptive conduct in creating, originating, marketing, and servicing mortgages.²⁵ Specifically, the complaint alleged that Countrywide used deceptive tactics in its loan-origination and servicing activities and that borrowers were often put in structurally unfair and unaffordable loans.²⁶ Pursuant to the settlement, Bank of America must suspend foreclosures for borrowers that are likely to qualify for a relief program. The relief program is offered to certain mortgages originated and serviced by Countrywide between January 1, 2004, and December 31, 2007.

Bank of America must also cease offering subprime or negative amortization loans and restrict no- or low-documentation loans.²⁷ It also agreed to stop offering pay option adjustable rate mortgages. Over \$220 million was set aside to fund relocation assistance, foreclosure relief, and financial assistance to borrowers in exchange for a release of claims. Similar to the approach taken by the courts in *Fremont* and *Option One*, the settlement institutes a standard payment-to-income ratio to be considered when initiating a loan.

The Massachusetts–Goldman Sachs Settlement (Pre-Lawsuit)

On May 11, 2009, Goldman Sachs reached an agreement with Massachusetts' AG. The agreement was a result of the AG's investigation of Goldman Sachs' subprime lending and securitization markets.²⁸ To prevent a potential lawsuit, similar to *Fremont* and *Option One*, Goldman agreed to provide loan restructuring valued at \$50 million to the borrowers. Goldman also agreed to make a \$10 million payment to the state and agreed to cooperate with the investigation as it progresses.²⁹

Structurally, Goldman agreed to significant principal write-downs to allow borrowers to refinance or sell their homes. For loans held by Goldman, it agreed to reduce the principal of first mortgages up to 35 percent and 50 percent for second mortgages. The reduction will come following six months of delinquent payments. For loans not held by Goldman but serviced by its affiliates, it agreed to assist borrowers with refinancing options and other alternatives to foreclosure.

New York v. Greenpoint

New York's AG accused Greenpoint of employing controlling race-related factors, which caused African-American and Hispanic customers to pay more for retail and wholesale loans.³⁰ The settlement reached between the parties requires Greenpoint to pay \$1 million in restitution, and

requires it to take actions against specific brokers whose pricing practices contributed to the racial disparity. The settlement further requires Greenpoint to enhance its monitoring of broker conduct, and impose stringent remedial measures against brokers who charge minorities higher prices.

The Fremont Settlement

On June 9, 2009, Fremont agreed to a settlement with Massachusetts and has agreed to pay Massachusetts \$10 million in consumer relief, civil penalties, and costs.³¹ This amount includes \$8 million in consumer relief, \$1 million in civil penalties, and \$1 million in costs, including attorney fees. The consumer relief funds are to be used to redress the impact of mortgage foreclosures and predatory lending practices, and to provide relief to Massachusetts' borrowers.

Fremont further agreed not to originate unfair loans in the state and has agreed not to foreclose upon unfair loans without following certain procedures. Such protections require Fremont, its assignees or servicers, to give notice to the AG's office prior to the initiation of foreclosure. Specifically, the AG's office must receive a 30-day notice prior to the initiation of foreclosure if the loan in question is "not presumptively unfair," the subject property is vacant or is not the borrower's primary residence.³² The AG's office must receive a 45-day notice if the loan in question qualifies as "presumptively unfair." Those protections against foreclosure, which have been in place since the injunction was issued in March 2008, are now permanent and apply to the loan holders and servicers who have acquired these loans since that time.

Conclusion

In light of the Massachusetts Supreme Judicial Court's decision, the concept of using a state UDAP statute to penalize lenders for defaulting loans is likely to continue. Time will tell just how detrimental to the lending industry the AGs' actions have been and will be. The vehicle used by Massachusetts' AG has already branched into Ohio, California, and New York, as evidenced by the prior AG settlements, and will likely continue to branch into other states that have broad enough UDAP statutes to support potential liability.³³ It should be noted, however, that many states' UDAP statutes are not so broad and thus will likely not support a similar outcome unless that state's UDAP statute is amended. Thus, the nationwide long-term effect of the AGs' actions on the lending industry remains uncertain.

What is clear, however, is that in many instances, defaulting homeowners can now turn to their state's AG for assistance in strong-arming their lenders to renegotiate

or dissolve the terms of their mortgage loans. Such strong-arming may not be appropriate in all instances (much of which is based on a retroactive application for conduct that was not previously illegal) and may end up hurting consumers more than it helps them as a drop in access to available credit is an inevitable byproduct of the AGs' actions. Thus, the question that will need to be addressed in the future is whether the AGs' actions have ended up helping or hurting consumers as a whole. ■

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Endnotes

1. See CAROLYN CARTER, NAT'L CONSUMER LAW CTR., INC., A 50-STATE REPORT ON UNFAIR AND DECEPTIVE ACTS AND PRACTICES STATUTES, available at www.consumerlaw.org/issues/udap/content/UDAP_Report_Feb09.pdf, 11 (last visited May 30, 2009).
2. The authors would like to acknowledge that in this publication's Spring issue, Ralph T. Wutscher addressed the issues of unfairness in the Massachusetts AGs litigation.
3. See *Commonwealth v. H&R Block, Inc.*, No. 08-2474-BLS1 (Mass. Super. 2008), available at www.consumerlaw.org/unreported/content/Mass_Block_Prelim_Inj.pdf (last visited May 31, 2009).
4. *Commonwealth v. Fremont*, Civil Action No. 07-4373-BLS1, available at www.mass.gov/Cago/docs/press/2009_06_09_fremont_consent_judgment.pdf (last visited June 10, 2009).
5. *Commonwealth v. Fremont Inv. & Loan*, 897 N.E.2d 548 (Mass. 2008).
6. *Id.* at 552-53.
7. *Id.* at 556.
8. Chapter 93A, section 2, makes unlawful any "unfair or deceptive acts or practices in the conduct of any trade or commerce." MASS. GEN. LAWS ch. 93A, § 2 (2004). It also creates new substantive rights, and in particular cases, "mak[es] conduct unlawful which was not unlawful under the common law or any prior statute." *Kattar v. Demoulas*, 739 N.E.2d 246 (Mass. 2000) (quoting *Commonwealth v. DeCotis*, 316 N.E.2d 748 (Mass. 1974)). The statute does not define unfairness, recognizing that "[t]here is no limit to human inventiveness in this field." *Kattar v. Demoulas*, 739 N.E.2d 246 (Mass. 2000) (quoting *Levings v. Forbes & Wallace, Inc.*, 396 N.E.2d 149 (Mass. App. Ct. 1979)). What is significant is the particular circumstances and context in which the term is applied. See *Kerlinsky v. Fidelity & Deposit Co.*, 690 F. Supp. 1112, 1119 (D. Mass. 1987), aff'd, 843 F.2d 1383 (1st Cir. 1988). It is well established that a practice may be deemed unfair if it is "within at least the penumbra of some common-law, statutory, or other established concept of unfairness." *PMP Assocs., Inc. v. Globe Newspaper Co.*, 321 N.E.2d

915 (Mass. 1975); see *Milliken & Co. v. Duro Textiles, LLC*, 451 Mass. 887 N.E.2d 244 (Mass. 2008).

9. See MASS. GEN. LAWS ch. 183C, § 2 (2004).

10. *Fremont*, 897 N.E.2d at 556.

11. *Id.*

12. *Id.*

13. *Id.* at 556.

14. *Commonwealth v. H&R Block*, No. 08-2474-BLS1 (Mass. Super. 2008), available at www.consumerlaw.org/unreported/content/Mass_Block_Prelim_Inj.pdf (last visited May 31, 2009).

15. *Id.* The requested documentation includes a complete copy of the loan origination file and the loan servicing file. *Id.* at 34.

16. *Id.* at 17.

17. *Id.* at 6.

18. *Id.* at 7. The commissioner also noted that “the terms ‘abusive lending’ or ‘predatory lending’ are most frequently defined by reference to a variety of lending practices. Although it is generally necessary to consider the totality of the circumstances to assess whether a loan is predatory, a fundamental characteristic of predatory lending is the aggressive marketing of credit to prospective borrowers who simply cannot afford the credit on the terms being offered.” *Id.* (citing AL 2003-2 at 2).

19. *Id.*

20. *Id.* at 45. The court decided to revise its criteria because it found that “most mortgage loans that fell into delinquency were so carelessly underwritten that the borrower could not afford them even before the payment shock kicked in.” *Id.*

21. *Id.* at 47 (stating that “loans that meet the other three criteria and have a loan-to-value ratio of at least 97 percent will be so risky to refinance that a borrower will almost invariably have to pay substantial points and fees as part of any refinancing, which will need to be added to principal in order for the borrower to afford them”).

22. *Ohio v. New Century Financial Corp., et al.*, Case No. 07-618660, * ¶ 21 (Ct. C.P. 2008), available at www.bricker.com/LegalServices/practice/banking/ealerts/finalentry.pdf (last visited May 31, 2009).

23. *Id.*

24. *Id.* at ¶ Order 2.

25. *California v. Countrywide Financial Corp.*, No. LCO83076, 2 (Cal. Sup. Ct. 2008), available at http://ag.ca.gov/cms_attachments/press/pdfs/n1618_cw_judgment.pdf (last visited May 31, 2009).

26. Press Release, Attorney General State of Ohio, State AGs Reach Agreement with Countrywide Financial to Help Almost 400,000 Borrowers Facing Foreclosure (Oct. 6, 2008).

27. *Countrywide*, No. LCO83076.

28. See Press Release, Attorney General of Massachusetts, Attorney General Martha Coakley and Goldman Sachs Reach Settlement Regarding Subprime Lending Issues, available at www.mass.gov (last visited May 14, 2009).

29. *Id.* The investigation is looking into whether Goldman Sachs has engaged in any of the following activities: facilitated the origination of unfair loans; failed to ascertain whether loans purchased from originators complied with the originators’ stated underwriting guidelines; failed to take sufficient steps to avoid placing problem loans in securitization pools; been aware of allegedly unfair loans; failed to correct inaccurate information in trustee reports; and failed to make available to potential investors certain information about unfair loans.

30. See Press Release, Office of the Attorney General, Attorney General Cuomo Obtains Approximately \$1 Million for Victims of Greenpoint’s Discriminatory Lending Practices, available at www.oag.state.ny.us/media_center/2008/jul/july16a_08.html (last visited May 31, 2009).

31. *Commonwealth v. Fremont*, Civil Action No. 07-4373-BLS1, available at www.mass.gov/Cago/docs/press/2009_06_09_fremont_consent_judgment.pdf (last visited June 10, 2009).

32. *Id.* In the preliminary injunction, the Superior Court held that certain Fremont loans were “presumptively unfair” because by their very terms were likely to lead to default and foreclosure.

33. This expansion could extend to Arkansas, Connecticut, the District of Columbia, Hawaii, Iowa, Kansas, Maine, Maryland, Missouri, New Jersey, Montana, New Mexico, Nevada, North Carolina, Oregon, and Vermont, which have broad UDAP statutes that include prohibitions against unfair and deceptive acts and practices. CARTER, *supra* note 1, at 24–29.