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Legal Updates & News

Bulletins

Financial Services Report, Spring 2007

March 2007

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In this issue:

Editor's Note

On the Edge

The history of humor in law firm newsletters may be the world's shortest book. There is plenty of blame to go around, but much of it rests with the Federal Reserve Board. The FRB is just not funny. If you want funny, think FEMA. And now NASA.

Consider the TSA, and its insistence on quart-sized baggies for carry-on liquids and gels. We imagine the conversation might have gone something like this: "How are we supposed to pick out the terrorists?" "Dummkopf! It's the *pint*-sized baggies." "No way!" "Listen up dude, we bought a used '*al-Queda* Training Manual' on eBay. It says right here: 'Cosmetics. Transportation of.'" The CIA must be wondering how it missed that. Meanwhile, pint-sizers go to pat down.

See what we mean? How can the FRB compete? If you know any good monetary policy jokes, send them on.

We may have celebrated Chinese New Year, but the Year of the Bore it is not. Did someone mention policy? The new Congress wants to do something about predatory lending, but first must figure out what it is. And data breach roars on. More breaches, including TJ Maxx, have spawned lawsuits from Mexico to Canada. This has stirred the pols. Massachusetts introduced a bill that would shift mass data compromise liability to merchants.

Not to be outdone, California wants to provide civil penalties of up to $2,500 per violation of a data security or breach notification rule.

Meanwhile, the "firm offer of credit" cases continue to simmer as we await the U.S. Supreme Court's "willful" ruling in the consolidated *Safeco/Geico* cases. Captive reinsurance continues to make headlines. All this, and plenty more in these pages.

This just in: As we went to press Zsa Zsa Gabor's husband (Prince Frederic von Anhalt) announced he might be the real editor of this newsletter. We're flattered, but insist on lab tests: Does the Prince know any FRB jokes?

Until next time, this space and your space is all MySpace.

William L. Stern, Editor

MoFo Metrics

5000	Dollars per pitch earned by San Francisco Giants pitcher Barry Zito
96	Dollars, in billions, waged annually by Americans on sports
3	Percentage of those sports wagers that are legal
65	Days per year average American adult spends in front of TV
1	Weeks per year average American will spend on Internet
2.1	Pairs of shoes, in billions, Americans buy annually
279	Cost, in thousands, of raising a child through age 17
60	Percentage of college grads who move in with their parents

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Beltway Report

Sharpen Pencils and Sit Up Straight

Congress has been busier than Anna Nicole Smith's probate attorney. It has decided to make college more affordable and wants lenders to contribute. As part of its "100 hours" agenda, the House passed the College Student Relief bill. It would reduce interest on need-based subsidized Stafford loans from 6.8% to 3.4% over five years and set a new rate in 2012. To offset the estimated $6 billion cost of the rate reduction, the bill will increase fees paid by loan providers. Senator Kennedy is spearheading similar legislation in the Senate.

For further information, contact Mark Gillett at mgillett@mofo.com.

The full text of this article is available at:

http://www.mofo.com/news/updates/files/8661.html

Ahead of the Summons

Class Actions Reconsidered?

The Second Circuit dropped a Fizzie® in the punchbowl in December when it decided *In re Initial Public Offering Securities Litigation*, 471 F.3d 24 (2007), a securities class action case. It reversed class certification in six "focus cases" from 310 consolidated class actions. The opinion is likely to affect more than those consolidated cases. Why? Because in granting class certification, the district judge applied a commonly used standard, namely, that plaintiffs need only make "some showing" of each of the FRCP 23 elements for certification. The Second Circuit said no. Class certification requires "making determinations that each of the Rule 23 requirements has been met," and a court considering class certification must "resolve[] factual disputes relevant to each Rule 23 requirement." 471 F.3d at 41.

The full text of this article is available at:

http://www.mofo.com/news/updates/files/8663.html

Privacy Report

No Breach Left Behind

Massachusetts is considering legislation (H. 213) that would require retailers to pay for losses that occur as a result of security system breaches. The Bay State bill is backed by bankers and would require retailers to reimburse banks for the costs of "reasonable actions" they take in response to a breach of data security, including cancellation or reissuance of credit cards, closure of accounts, stop-payments on checks, reopening of closed accounts, and any fraudulent charges made as a result of unauthorized transactions. If enacted, the bill would be the first such statute in the country, but a similar proposal may be introduced in Connecticut and at the federal level.

The full text of this article is available at:

http://www.mofo.com/news/updates/files/8664.html

California Report

California Privacy

January brought two important privacy cases for California class actions. First, the California Supreme Court held that potential class member customers' privacy rights do not require their affirmative consent before a class action defendant can be ordered to produce contact information as to unnamed class members. *Pioneer Elecs. (USA), Inc. v. Super. Ct.*, 40 Cal. 4th 360 (2007). The court held that the customers' privacy right would be adequately protected by notice and an opportunity to opt out of disclosure. Although the California Constitution protects an individual's "reasonable expectation of privacy against a serious invasion," an "opt-out" procedure strikes the proper balance between the plaintiff's need to know and the complaining customers' privacy rights. In reaching this result, the court reaffirmed the approach it took over thirty years ago in *Valley Bank of Nevada v. Superior Court*, 15 Cal. 3d 652 (1975), in which the court balanced the need for discovery with the consumers' right to privacy in their financial affairs.

The full text of this article is available at:

http://www.mofo.com/news/updates/files/8665.html

Operations Report

Basel II Basics

The federal bank regulators published their joint proposal on supervisory guidance related to Basel II implementation. (72 Fed. Reg. 9084 (Feb. 28, 2007).) The proposed guidance describes agency expectations for banking organizations that would adopt the advanced internal ratings-based approach for credit risk, and the advanced measurement approaches for operational risk. The proposal also includes guidance on the Basel II supervisory review process for assessing capital adequacy. The comment deadline is May 29.

The full text of this article is available at:

http://www.mofo.com/news/updates/files/8666.html

Firm Offer Update

The Firm serves as coordinating counsel to the Mortgage Bankers Association in the so-called “firm offer of credit” class actions, so each issue we track the developing case law under the FCRA relating to this latest “Pet Rock” of the class action bar.

Great Chase Case

On March 5, the district court in New York City handed down what might be the single most favorable “firm offer” decision to date. In *Nasca v. J.P. Morgan Chase Bank N.A.*, Judge Stein found that that an “up to $417,000 or more” mortgage offer met the FCRA’s statutory definition. He rejected the argument that conditioning the offer on application and collateral made it illusory, and the notion that the FCRA requires that the solicitation disclose credit terms. Judge Stein declined to follow *Cole v. U.S. Capital, Inc.*, 389 F.3d 719, 725 (7th Cir. 2004), concluding that it implies a value term that is not found in the statute.

For more information, contact Michael Agoglia at magoglia@mofo.com.

The full text of this article is available at:

http://www.mofo.com/news/updates/files/8667.html

Credit Card Report

Staring Down the Pols

The Senate Banking Committee held hearings in February on the impact of credit card industry practices on consumers. The real focus of the hearings was to jawbone the credit card industry into voluntarily abandoning

such practices as universal default and double-cycle billing. Senator Christopher Dodd (D-Ct.), chairman of the committee, made it clear from his opening remarks that this was going to be a bully pulpit: "If you currently engage in any business practice that you would be ashamed to discuss before this Committee, I would strongly encourage you to cease and desist that practice. Irrespective of the current legality of such practices, you should take a long, hard look at how you treat your customers, both in the short term and the long term." Several senators (including Chairman Dodd) said they thought these practices should be eliminated or changed. On March 1, one large card issuer announced it would end "universal default."

For more information, contact Jim McCabe at jmccabe@mofo.com.

Overdraft Overture

Meanwhile, the industry caught flak from the new Chair of the Financial Institutions Subcommittee of the House Financial Services Committee, Representative Carolyn Maloney, D-N.Y. She announced in February that she would reintroduce her legislation on overdraft fees in the wake of a study by the Center for Responsible Lending claiming that debit card overdrafts make up a sizable portion, 46%, of total bank overdrafts, and are more expensive than check overdrafts. The legislation would require consumer opt-in to overdraft protections, and would require that consumers be alerted when they are about to overdraw from their account at ATMs.

For more information, contact Nancy Thomas at nthomas@mofo.com.

Does California's CLRA Apply to Credit Cards?

No, according to *Berry v. American Express Publishing, Inc.*, 147 Cal. App. 4th 224 (2007), in which a California appellate court found that challenges to credit card practices are not subject to the California Consumer Legal Remedies Act. The court noted that the CLRA applies only to "goods" and "services," and found that the extension of credit does not fall within either category. Although credit card issuers have had some success with this argument, *Berry* is the first published decision to reach this result.

For more information, contact Nancy Thomas at nthomas@mofo.com.

Arbitration Report

We'll Have Fun, Fun, Fun . . .

There is some good arbitration news from California. An appellate court recently upheld a class action waiver in an employment case, repeating its earlier ruling in *Gentry v. Superior Court*, 135 Cal. App. 4th 944 (2006), that class action waivers are not unconscionable unless putative class members' claims are "predictably small." *Konig v. U-Haul Co. of Cal.*, 145 Cal. App. 4th 1243 (2006). Alas, this was a short-lived victory. The California Supreme Court promptly granted review in *Konig*.

. . . Until Her Daddy Takes the T-Bird Away

Continuing the trend of increasing hostility toward arbitration clauses, the Ninth Circuit ruled *en banc* that under the FAA, courts, not arbitrators, decide whether an arbitration clause is unconscionable. *Nagrampa v. Mailcoups, Inc.*, 469 F.3d 1257 (9th Cir. 2006). Several other circuits have rejected this approach, finding that unconscionability is a challenge to the entire contract to be decided by the arbitrator and that plaintiff may not apply it selectively to the arbitration clause to create jurisdiction for the courts.

The Ninth Circuit applied California law to find the agreement unconscionable. The court set the bar exceedingly low, finding procedural unconscionability based on unequal bargaining power and inability to negotiate terms, and substantive unconscionability based on unequal access to a judicial forum and designation of an unfair location for the arbitration. *Id.* at 1281-93. (MoFo lawyers Shirley Hufstedler and Ben Fox represented the AAA in the appellate proceedings.)

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Mortgage Report

The Pendulum Swings Back

In our Summer 2006 issue, we reported on a closely watched appeal in the First Circuit involving a class certification order in a TILA rescission case. On January 29, the First Circuit reversed the much-criticized class certification order in *McKenna v. First Horizon Home Loan Corp.*, No. 06-8018, 2007 U.S. App. LEXIS 1901 (1st Cir. Jan. 29, 2007). The court held that rescission claims under TILA cannot be aggregated for class action purposes because "Congress did not intend rescission suits to receive class-action treatment." Adopting the views promoted by First Horizon and the industry *amici*, the court concluded that TILA's $500,000 class action damages cap implicitly bars class action treatment of rescission claims, which would impose on lenders "overwhelming liability for relatively minor violations."

The full text of this article is available at:

http://www.mofo.com/news/updates/files/8668.html

Creditor's Rights and Bankruptcy

Supremes to Decide Key FCRA Issue

Oral argument was held in January before the United States Supreme Court in two consolidated FCRA cases: *Safeco v. Burr*, 06-84, and *Geico v. Edo*, 06-100. The cases, of intense interest to both business and consumer groups, arise out of the Ninth Circuit and its definition of what constitutes a "willful violation" of the Fair Credit Reporting Act's consumer notice requirements. The industry contends the Ninth Circuit's definition is too broad and encourages frivolous and costly class action lawsuits. Naturally, consumer groups and the plaintiffs' bar disagree, contending that the more restrictive standards advocated by business interests will stifle both private attorney general suits and government enforcement activities. The U.S. Solicitor General and the FTC back the Ninth Circuit and consumer groups on this one. Stay tuned for a report on the Court's decision.

For more information, contact Beth Brinkmann at bbrinkmann@mofo.com.

FAMCO Fallout

In December, the Ninth Circuit issued its opinion in *Henry v. Lehman Commercial Paper, Inc.*, 471 F.3d 977 (9th Cir. 2006), a consolidated appeal addressing two class actions litigated in connection with the bankruptcy proceedings of First Alliance Mortgage Company. The Ninth Circuit affirmed the jury's verdict that Lehman, First Alliance's lender and underwriter of its securitized debt, aided and abetted First Alliance's fraud on consumers. However, on the borrowers' and bankruptcy trustee's consolidated actions to subordinate Lehman's $77 million in secured debt to the borrowers damaged by First Alliance's fraud and other general unsecured creditors, the Ninth Circuit affirmed the trial court's holding denying the trustee's requested relief. Notwithstanding the jury's findings that Lehman had aided and abetted First Alliance's fraud, the Ninth Circuit agreed with the trial court's finding that there was no evidence that Lehman's misconduct had been done in contemplation of a bankruptcy petition by First Alliance, and that Lehman had done nothing to better its position vis-à-vis any other creditor.

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