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Legal Updates & News

Bulletins

Financial Services Report: Staying Ahead of the Summons

June 2007

Financial Services Report, Summer 2007

PDF Version

In this issue:

On the Edge

June is Celibacy Awareness Month. Let's party. Or, do only the celibate celebrate?

June is all things to all people. June accommodates both National Dairy Month andNational Dairy *Alternatives* Month. June is also Adopt-a-Cat, Turkey Lovers, Ice Tea, Candy, and Learn French Months. (Excusez-moi, puis-je vous offrir du thé glacé et de la dinde?) And the mind boggles at the different ways a fête of National Fireworks Safety Month and National Accordion Awareness Month might be combined. Isn't June also National Aphasia Awareness Month? We forget.

Time now for un petit confession. Attentive readers may have noticed that some items in past issues appear to have been strangely clever. If so, we apologize. Our need to please has caused us to dabble occasionally in performance-enhancing substances, as the urine tests have now confirmed. Auditors are reexamining past issues in search of anything suspiciously humorous. Thankfully, they have found nothing incriminating. Still, we regret any offense, and are entering rehab. As we told the grand jury, we thought "clear" was vanishing acne medication.

Other readers have noted these pages' excessive references to Anna Nicole Smith. Yes, there is another gratuitous reference in this issue. Please forgive us this last indulgence, since that problem appears to have solved itself this quarter. And identifying Dannielynn's real father was like getting a bonus gift.

Speaking of DNA, OpSubs of national banks found out this quarter the answer to "Who's your daddy?" The United States Supreme Court's decision in *Watters v. Wachovia* resolved that dispute, and pointed the way to paternity: Their national bank parents. OpSubs, like Dannielynn, inherit what their parents have, including National Bank Act preemption.

Congress has been distracted this quarter, but the regulators have been busy, so the Beltway Report is a must read, ditto our "Firm Offer" update. The Privacy front has been active too, including the fatwa some states have declared on merchants as a result of the TJX flapdoodle. All this, and more, inside.

Until next time, and in keeping with our informal approach, we pledge: No new tuxes.

William L. Stern, Editor

MoFo Metrics

90 Weapons per 100 citizens (U.S.)

39 Weapons per 100 citizens (Iraq)

16 Billions of dollars spent on Mother's Day

27 Average cost of U.S. wedding, in thousands of dollars

30 Billions of single-serve containers of bottled water consumed each year in U.S.

305 Estimated cost in dollars to a company of a data breach, per record

68 Millions of dollars a large bank will spend on average complying with Basel II

575 Class actions filed since January 2004 by Daniel Edelman

Beltway Report

Scrabble for Bankers

How many words can you spell with the letters B, E, M, Z, and DD? The Federal Reserve Board wants to know. It has requested public comment on proposed amendments to five consumer financial services and fair lending regulations (Regulations B, E, M, Z, and DD) clarifying consumer electronic disclosure requirements. The proposed amendments simplify the Board's rules by withdrawing 2001 interim final rule sections restating provisions of the Electronic Signatures in Global and National Commerce Act ("E-Sign Act") and provisions imposing undue burdens on electronic banking and commerce; and retaining certain provisions providing guidance on electronic disclosures. The same proposal mandates certain disclosures for online credit card solicitations pursuant to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

The full text of this article is available at:
http://www.mofo.com/news/updates/files/12384.html

Ahead of the Summons

Irritable TILA Syndrome

Get out your "I'm with Stupid" T-shirts. In our last several issues, we have been tracking the demise of rescission class actions under TILA. A district court in April recognized this, yet it nevertheless allowed a *declaratory relief* claim authorizing class members to individually request that their loans be rescinded. *In re Ameriquest Mortgage Co. Mortgage Lending Practices Litigation*, ___ F. Supp. 2d ___, 2007 WL 1202544 (N.D. Ill. April 23, 2007). Break into small groups and discuss.

The full text of this article is available at:
http://www.mofo.com/news/updates/files/12386.html

Privacy Report

Super Models

Eight—count ’em—federal agencies have joined forces to simplify the privacy notices that financial institutions must send to individual customers under the Gramm-Leach-Bliley Act (“GLBA”). Apart from designing a new “model form” privacy notice as mandated by the regulatory relief legislation enacted last fall, the interagency proposal would establish a safe harbor for those institutions that use the prescribed language and format of the model form. This, friends, is a single-sided, 8.5 by 11-inch single sheet disclosure.

The full text of this article is available at:
http://www.mofo.com/news/updates/files/12387.html

California Report

Waiting for *Miller*

Pessimists and disaster voyeurs, they say, watch the Weather Channel. Now, we can wait for the California Supreme Court to decide *Miller v. Bank of America*.

The California Supreme Court agreed on March 21 to review an appeal court decision that overturned a $1.5 billion judgment that Bank of America Corp. was ordered to pay to over a million California class members. A court of appeal in San Francisco last November ruled in the bank’s favor, holding that banks may apply credits for Social Security benefits and other public benefit payments directly deposited to their customers’ checking accounts, to cover debits for overdrafts and overdraft fees. The appeal court had overruled an earlier San Francisco County Superior Court decision that found such payments to be illegal under California law.

The full text of this article is available at:
http://www.mofo.com/news/updates/files/12388.html

Operations Report

Standing By

Launch the bottle rockets! The new rules for commercial letters of credit will become effective July 1, 2007.

The UCP 600 will replace the former ICC rules, designated UCP 500, adopted in 1993. The UCP 600, like UCP 500, is not self-executing. It applies only to credits that invoke it. Letters of credit generally are subject to Article 5 of the Uniform Commercial Code and, if incorporated in the credit, subject also to other sources of law. (*See e.g.* ISP 98 (ICC Publication 590—standby letters of credit; UNCITRAL Convention on Independent Bank Guarantees and Standby Letters of Credit; SWIFT rules and regulations.) Like UCP 500, the focus of UCP 600 is on commercial rather than standby letters of credit. The UCP 600 contains a number of changes that will require review and modification of policies and procedures for banks that issue commercial letters of credit. For example, UCP 600 changes the time limit for examination of documents by an issuing bank to an absolute period of five calendar days. The former rule was a reasonable period of time.

The full text of this article is available at:
http://www.mofo.com/news/updates/files/12389.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.

Overall: While the pace of new case filings has slowed, the legal uncertainty over the proper interpretation of the FCRA's firm offer requirement has, if anything, only accelerated.

Outside the Seventh Circuit: District courts have increasingly tended to dismiss firm offer challenges. From defendants' perspective, the single best decision to date is perhaps *Nasca v. J.P. Morgan Chase Bank, N.A.*, No. 06 Civ. 3472 (SHS), 2007 U.S. Dist. LEXIS 15629 (S.D.N.Y. Mar. 5, 2007). There, Judge Stein thoroughly rejected the argument that the FCRA contains a "value" requirement. Judge Stein also rejected the related notion that the FCRA requires mailers to disclose specific pricing information, such as rate and loan amount, adding that "it is not for the judiciary to add requirements that do not exist in the statute." *Id*., at *13.

Seventh Circuit: The trend in FCRA cases within the Seventh Circuit has been more mixed. The case which, in our view, most clearly displays the distance judicial analysis has traveled from statutory language and congressional intent is *Bonner v. New Century*, No. 2:05-cv-146 (N.D. Ind. Mar. 9, 2007). In that case, the court interpreted *Cole* and *GMAC* not only to require a "value" inquiry, and to limit that inquiry to the mailer information, it also found the fact that the lender required the borrower to submit an application in order to determine the pricing information available to the particular consumer was further evidence of a FCRA violation. In this way, the court exemplified the shift away from *Cole*'s emphasis on assessing the value of the credit offered, to a solitary focus on the value of the information in the mailer. Many viewed this as particularly disturbing, given how the statutory definition expressly permits firm offers to be conditioned on receipt of an application.

The Seventh Circuit is also considering a significant appeal in *Murray v. HSBC*. The district courtgranted summary judgment for HSBC, finding that nothing in *Cole* or the FCRA required the disclosure of specific pricing information in the initial solicitation. 2006 U.S. Dist. LEXIS 74128 (N.D. Ill. Sept. 27, 2006). The district court also found that HSBC did not willfully violate the FCRA, based on evidence that HSBC maintained a FCRA compliance program that included the review of mailers by outside counsel. If affirmed, that decision could signal the end of firm offer litigation in the Seventh Circuit.

Ninth Circuit: The Ninth Circuit is also considering an appeal in *Putkowski v. Irwin Home Equity Corp.* The district court had rejected the oft-raised claim that a change-in-terms notice in a mailer means that the mailer is not a firm offer of credit. 423 F. Supp. 2d 1053, 1060 (N.D. Cal. 2006). More significantly, after carefully reviewing the FCRA, the court concluded that "[t]he text of the FCRA does not support plaintiffs' suggestion that a firm offer of credit cannot contain a range of credit or interest rates, or that it must be of sufficient 'value' when judged by a later arbiter, as suggested by the Seventh Circuit in *Cole*." The issue on appeal is whether *Cole*'s analysis, which implied the term "value" within the FCRA's definition of firm offer of credit, will be followed elsewhere.

Presently, both *Putkowski* and *HSBC* are fully briefed and waiting for oral argument. Decisions are likely to come down in these cases within the next four months to a year.

Geico/Safeco: The United States Supreme Court is expected to announce by July its decisions in the *Geico/Safeco* cases, which will likely articulate the governing standard for proving a willful violation of the FCRA. Because plaintiffs have only succeeded in certifying classes that seek statutory damages under the FCRA, and statutory damages are available only for willful violations, the outcome of the *Geico/Safeco* appeals could dramatically affect the course of all FCRA litigation.

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

Arbitration Report

If you operate a business with a nationwide footprint, your arbitration clause may be only as good as the state or federal circuit taking the most restrictive approach toward arbitration. This quarter, the Ninth Circuit put in a strong bid for that appellation.

The Ninth Circuit doesn't much like arbitration. It continues to closely scrutinize orders compelling arbitration. In

April, the Ninth Circuit determined that a district court failed to first rule upon the existence of the contract before compelling arbitration, and therefore vacated the district court's order compelling arbitration. *Sanford v. MemberWorks, Inc.*,2007 U.S. App. LEXIS 8622 (9th Cir. April 16, 2007). And in May, it invalidated an arbitration clause used by the national law firm O'Melveny & Myers, finding that the clause, which was applicable to all employees, was both procedurally and substantively unconscionable. *Davis v. O'Melveny & Myers,* 2007 U.S. App. LEXIS 11265 (9th Cir. May 14, 2007). The court found four features to be substantively unconscionable : (1) a mandatory requirement of one year within which to give notice of a claim, thereby shortening the statute of limitations for employment-related claims; (2) an overly broad confidentiality provision; (3) non-mutuality, allowing O'Melveny to litigate in court for certain breaches of the attorney-client privilege and the work product doctrine; and (4) its applicability to all administrative proceedings.

In contrast, the California Court of Appeal found that the Federal Arbitration Act preempts contrary California law allowing a purchaser of real property to bring an action in court for construction and design defects. *Shepard v. Edward Mackay Enterprises, Inc.*, 148 Cal. App. 4th 1092 (2007). But in *Lee v. Southern California University for Professional Studies* 148 Cal. App. 4th 782 (2007), the appellate court held that arbitration would not be required as to a class action plaintiff because she had not signed an arbitration agreement, even though many of the other putative class members had signed arbitration agreements. The court found that whether the representative plaintiff was an adequate class representative for those who did sign an arbitration agreement was a question it could decide later when presented with a motion for class certification.

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Preemption Report

Parting of the *Watters*

For those who lied awake during the Anna Nicole Smith autopsy watch, the suspense surrounding the United States Supreme Court's decision in *Watters v. Wachovia Bank, N.A*. could hardly compare, but it came pretty close. The U.S. Supreme Court set the record straight by clarifying that operating subsidiaries of national banks should have the same preemption from state consumer protection laws as the banks themselves. Under the National Bank Act "national banks may conduct certain activities through 'operating subsidiaries,' discrete entities authorized to engage solely in activities the bank itself could undertake, and subject to the same terms and conditions as those applicable to the bank."

The Court's decision is important as it upheld the decision by the Sixth Circuit and is consistent with the OCC's preemption rules, which clarified that operating subsidiaries have the same preemption rights as national banks. The Court opined that "just as duplicative state examination, supervision, and regulation would significantly burden mortgage lending when engaged in by national banks ... so too would those state controls interfere with that same activity when engaged in by an operating subsidiary."

In support of the decision, the OCC issued a press release stating that the OCC "is pleased that the Court's decision supports the ability of national banks to continue to conduct business activities in their operating subsidiaries as they are now doing."

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

Mark-Up Claims Preempted

A district court inSan Francisco held that a mark-up class action against a mortgage lender based on alleged violations of RESPA and California's unfair competition law is preempted by the National Bank Act. *Martinez v. Wells Fargo Bank, N.A.*, ___ F. Supp. 2d ___, 2007 WL 963965 (N.D. Cal. March 30, 2007). The plaintiffs in that case challenged Wells Fargo Bank's fees for automatic underwriting, tax, and document preparation services. The district court also threw out the RESPA claims because Section 8(b) does not extend to overcharges. In this respect, *Martinez* is consistent with rulings from the Second, Third, Fourth, Seventh, and Eighth Circuits.

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

Mortgage Report

Is the Party Over?

This year has not been kind to the subprime mortgage lenders. Several recently high-flying lenders have sold their operations, sharply curtailed or ceased making subprime loans, or even—most prominently, in the case of New Century Financial—filed for bankruptcy protection. As the shockwaves continue to reverberate through the entire mortgage and housing industries, regulators, lawmakers, consumers, and lenders (and their lawyers) ponder what's next and what can be done.

On May 17, Fed Chairman Ben Bernanke, addressing the recent problems in the subprime industry, struck a decidedly non-alarmist note. Acknowledging that the industry is facing serious difficulties and internal restructuring, Bernanke identified several "signs of self-correction in the market," such as tightening underwriting standards and the increased role of investment banks, hedge funds, and other private pools of capital "to fill the void" in the purchase of securitized subprime mortgages. Bernanke also expressed hope that lenders would try to work with borrowers to restructure loans whenever possible to avoid foreclosure. Bernanke did not offer any specific regulatory solutions to the current market woes, but he indicated that the Fed is conducting a "top-to-bottom" review of TILA, HOEPA, and Regulation Z to determine if consumer disclosures can be improved to reduce fraud and consumer abuse.

Congress has several bills pending that would reform subprime practices. *See* "Beltway Report," above.

For more information, contact Eric Olson at eolson@mofo.com.

GAO Whacks Title Industry

In April, the Government Accountability Office ("GAO") released a 74-page report on competition in the title insurance industry. The report notes significant problems in the title insurance industry, particularly with the limited ability of consumers to comparison-shop for the best rates and services. The GAO recommends that federal and state insurance regulators "strengthen the regulation and oversight of the title insurance market, including the collection of data on title agents' operations." The report further recommends that Congress consider amending RESPA, such as by "providing HUD with increased enforcement authority for Section 8 RESPA violations, such as the ability to levy civil money penalties."

For more information, contact Eric Olson at eolson@mofo.com.

Taming the GSEs

Republicans and Democrats seem able to agree on one thing: Fannie Mae, Freddie Mac, and the Federal Home Loan Banks need a smaller carbon footprint. A bipartisan bill to reform and restructure the regulatory system for GSEs has been introduced by House Financial Services Committee leaders. Although earlier attempts at reform failed, the pending bill reflects a bipartisan agreement between Treasury Secretary Paulson and Committee Chairman Frank, giving the bill a good chance of success.