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Subprime Advisory: Subprime Lender Enjoined from Foreclosing on Mortgage Collateral

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In a decision widely characterized as both "important" and "unprecedented," on February 28, 2008, a Massachusetts Superior Court judge enjoined a subprime lender, Fremont Investment & Loan of California ("Fremont"), from foreclosing on many of its mortgages with Massachusetts subprime borrowers without the express prior approval of the Attorney General.[1]

Justice of the Superior Court, Ralph D. Gants, found that Fremont's lending practices were "unfair and deceptive acts or practices" in violation of M.G.L. c. 93A, § 2. As a result, Fremont has been enjoined from foreclosing on any of its roughly 3,000 remaining active mortgages in Massachusetts without the Attorney General's express written approval.

In issuing his findings, Judge Gants determined that the presence of four factors (the "Four Factors") in each Fremont loan, when taken together, were "presumptively unfair" and in violation of Chapter 93A:

- the loan is an adjustable rate mortgage with an introductory period of three years or less;
- the loan has an introductory or "teaser" rate for the initial period that is at least 3% lower than the fully indexed rate (*i.e.*, the adjusted rate at the end of the introductory period);
- the borrower has a debt-to-income ratio that would exceed 50% if the lender's underwriters measure the debt not by the debt due under the teaser rate, but by the debt due under the fully indexed rate; and
- the loan-to-value ratio is 100%, or the loan carries a substantial prepayment penalty or a prepayment penalty that extends beyond the introductory period.

Notably, the court did not find any fraud in the inception of these loans (*i.e.*, Fremont did not deceive the borrowers, did not make any false representations in its loan terms, did not conceal anything from the borrowers, and did not make any misrepresentations in the closing documents). Moreover, the court acknowledged that it was the custom and practice for subprime lenders to have one or all of the Four Factors present in their mortgage loans. Nevertheless, the court held that the "unfairness…does not rest in deception but in the equities between the parties," and that because it was "unfair to issue a mortgage loan when the lender reasonably believed that the borrower could not meet its scheduled payments," a mortgage loan evidencing the Four Factors violated this fairness principle.

It will be interesting to see if the Massachusetts Attorney General will use the findings in *Fremont* to broaden its authority over other subprime lenders whose loans exhibit the characteristics identified by the court. Massachusetts lenders should closely monitor the ultimate results of the *Fremont* case and the treatment by Massachusetts courts of any future claims of lending unfairness brought by the Attorney General and/or borrowers.

Post-Script

Since the injunction was issued, Fremont entered into an asset purchase agreement to sell the servicing rights to approximately 300 of its Massachusetts loans to Carrington Mortgage Services, LLC ("Carrington"). Under the express terms of the asset purchase agreement, Carrington was not to accept the obligations imposed upon Fremont with regard to these loans under the court's February 25, 2008 injunction. The original findings of the court did not prohibit a sale of the loans and was silent as to the continuing effect of the injunction on the buyer of such loans. The Attorney General filed a motion to modify the injunction to prevent the sale to Carrington. On March 31, 2008, the court agreed to allow Fremont to consummate the sale of the loans to Carrington (it feared that prohibiting the sale would put Fremont into receivership), but it modified the original injunction to enjoin any future sale of the Fremont loans unless such future sale is made expressly subject to the obligations imposed upon Fremont set forth in the injunction.

Free Video Podcast Download

A video podcast of a recent presentation by Mintz Levin Subprime Practice Group Co-Chairs Rich Moche and Jack Sylvia, and Member Bridget Rohde, entitled "Take Stock of Your Own House: Proactively Responding to the Subprime Crisis," is available for download. The presentation provides guidance regarding how to respond to the many governmental investigations that are underway and how conducting an internal investigation can be an important safeguard in preparing to respond to such governmental investigations.

Endnotes

[1] *Commonwealth of Massachusetts v. Fremont Investment & Loan and Fremont General Corp.*, Mass. Sup. Ct., Civil Action No. 07-4373-BLS1.

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