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Financial Services Report

Staying Ahead of the Summons

Award Winning Newsletter

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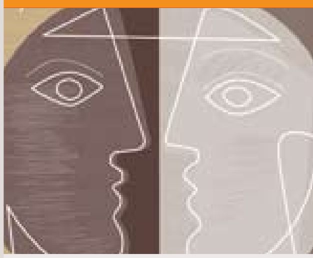

Inside

Editor's Note

Scoop Alert: Treasury Secretary Geithner and Fed Chief Bernanke appeared at a March hearing before Rep. Barney Frank wearing the same necktie. Think about that. What message should we draw? That next to this fashion pas de deux, rescuing the free world's banking system is simple choreography? Product placement for struggling clothing retailers? Civil service camouflage? Maybe it was just political cravat-ness.

The mainstream press missed this, but the gents selected a conservative striped tie, a line graph declining sharply from left to right. Why couldn't they have chosen a nice paisley or a J Garcia® tie-dye? Something that says "Follow me! I am blazing a new trail." That might have boosted consumer confidence. As it was, they looked like they were wearing January's stock chart as a noose.

The theme of this issue is Capitol Punishment. As in Washington D.C. Between stress tests and credit card reform, mortgage cram downs and executive compensation, you'd think Congress and the regulators have been reading the CIA's top secret witness interrogation manual. All of this news was starting to harsh our mellow.

Credit cards took center stage, with President Obama signing into law a law ominously titled "Credit Cardholders Bill of Rights," which is even more restrictive and takes effect sooner than the Fed's December overhaul. It signals a sharp detour from risk-based pricing. There were also new case decisions on default-pricing class actions. Mortgages weren't far behind, with lots of developments in the courts and in Washington. The developments in the financial crisis are enough to make our Inbox explode, too many to chronicle here in full. So, in many instances we give a brief description and invite those so inclined to check our online Client Alerts at www.mofo.com. As we told the congressional oversight committee, this is a newsletter, not Tolstoy.

Until next time, watch for our daily tweets about Bo, the Portuguese water dog, declare group hugs, and have a great summer. ■

William L. Stern, Editor

MoFo Metrics

11.2	Trillions of dollars Americans lost in net worth, 2008
8	Number of women basketball players who have executed a slam dunk
300	Organizations offering eco-seals on consumer products
60	Top speed (in mph) achieved by competitive U.S Lawn Mower racers
800	Rounds of golf played by Pres. Eisenhower during his presidency
7.50	Average cost per customer of a live customer service representative, in dollars
2.35	Average cost if outsourced to another country, in dollars
.32	Average cost for automated phone response system, in dollars

Beltway Report

ONE LUMP OR TWO?

The President signed two important pieces of mortgage legislation. In one, the lending industry avoided a bankruptcy cramdown provision. If this got you singing "Superfreak" in the shower, you're not alone.

The Helping Families Save Their Homes Act more than triples the FDIC's borrowing authority to $100 billion, with a $500 billion line of credit through 2010, boosts FDIC deposit insurance coverage to $250,000 from $100,000 through 2013, while establishing protections for renters living in foreclosed homes and the right of homeowners to know who owns their mortgage. The law also includes a safe-harbor provision to help homeowners refinance by shielding loan-servicing companies from lawsuits if they modify a loan at risk of default. But mostly, it could have been worse.

The Fraud Enforcement and Recovery Act creates an independent commission to investigate the causes of the current financial and economic crisis. The commission will examine the role of regulators and the Federal Reserve, corporate accounting practices, executive pay, and exotic investment tools. This legislation also expands the DOJ's authority to prosecute crimes involving mortgage and commodities fraud, and fraud involving U.S. government assistance provided during the recent economic crisis. It redefines "financial institution" for federal criminal purposes to include private mortgage brokers and companies not directly regulated or insured by the federal government. Also, it authorizes up to $165 million in new resources for FY 2010 and 2011 to hire fraud prosecutors and investigators.

GIVE PIZZA CHANCE

Treasury Secretary Geithner laid out the administration's "single regulator" reform plan that would provide for a single, independent regulator to oversee all "systemically important" financial firms and payment and settlement systems. Details will be announced in June, but this sounds big.

The plan would consolidate the OCC and the OTS and strip supervisory powers from the Fed and the FDIC. It would empower Treasury and the FDIC, in consultation with FRB, to stabilize and wind down such institutions, and give the FDIC powers to take large financial institutions that are not banks into receivership. "Systemically important institutions," which could include banks, bank holding companies, and non-banks, would be subject to higher capital and risk management standards. The proposal would also require hedge funds above a certain size to register with the SEC, regulate credit default swaps and over-the-counter derivatives, and strengthen regulation of money market funds to reduce the risk of rapid withdrawals. The administration wants this regulatory reform enacted by the end of the year.

For more information, contact Ollie Ireland at oireland@mofo.com.

REG Z AMENDMENTS FOR PRIVATE STUDENT LOANS

The Federal Reserve Board ("FRB") proposed amendments to Reg Z implementing provisions of the Higher Education Opportunity Act and requiring creditors extending private education loans to provide disclosures about loan terms and features on or with the loan application, and to disclose information about less costly alternatives. Additional disclosures would be required when the loan is approved and consummated; model forms satisfying this requirement are proposed. These requirements apply to postsecondary education loans but not to loans made, insured, or guaranteed by the federal government, subject to Department of Education rules. The proposal also implements the Act's restrictions on using the name, emblem, or mascot of an educational institution in a way implying that the institution endorses the creditor's loans. The public comment period ends 60 days after publication of the proposal in the *Federal Register*, which is expected shortly.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

TALF UPDATE

On May 1, FRB announced updated terms and conditions for the Term Asset-Backed Securities Loan Facility ("TALF"), a joint program with the U.S. Treasury Department ("Treasury") to provide low-cost funding to purchasers of asset-backed securities ("ABS"). The updated terms include the following: Commercial Mortgage-Backed Securities ("CMBS") issued after January 1, 2009, will be eligible for a new series of monthly auctions beginning in late June; 5-year TALF loans will be available from the Federal Reserve Bank of New York for CMBS and for ABS backed by student loans and loans guaranteed by the Small Business Administration, an extension of the program's currently available 3-year loans; and ABS backed by insurance premium finance loans will be eligible for TALF beginning in the June auction.

For more information, contact Amy Moorhus Baumgardner, abaumgardner@mofo.com, or Anna T. Pinedo, apinedo@mofo.com.

WAITING TO EXFOLIATE

Treasury issued details on its Public-Private Investment Programs to buy troubled mortgage loans and mortgage-backed securities from banks. The programs will use $75 to $100 billion in TARP funds and capital from private investors to generate $500 billion to purchase troubled assets, with the potential to expand to $1 trillion over time. The PPIP has two components: a "Legacy Loan Program" and a "Legacy Securities Program." The Legacy Loan Program would encourage private investors to buy loans from banks, while the Legacy Securities Program draws private capital into the mortgage-backed securities market by providing debt financing from the Federal Reserve under the TALF and through matching private capital. Executive compensation restrictions will not apply to either program. Details to follow through rulemaking.

DR. CHUCKLE AND MR. HIDE

Buried in the massive omnibus budget bill signed by the President is a provision that seems to give state attorneys general new authority to enforce TILA, and the FTC authority to write rules related to mortgage lending and intervene in state actions to enforce mortgage rules or TILA. Several concerned Senators held a floor discussion to address the intent of the legislation, which clarified that the bill was not intended to expand the FTC's authority over banks or to apply state enforcement actions to mortgage industry participants supervised by federal banking regulators. A colloquy is not part of the legislation, but courts often look to it when the legislation is unclear. The Senators expressed the intention to pass legislation "at the earliest possible time" to correct the provision.

For more information, contact Will Stern at wstern@mofo.com.

FINAL REG D AMENDMENTS

FRB approved final amendments to Regulation D to liberalize the types of transfers consumers can make from savings deposits and to make it easier for community banks that use correspondent banks to receive interest on excess balances held at Federal Reserve Banks. The amendments increase from three to six the permissible monthly number of transfers or withdrawals from savings deposits, and authorize excess balance accounts at Federal Reserve Banks, which are limited-purpose accounts for maintaining excess balances of one or more institutions that are eligible to earn interest on their Federal Reserve balances, in order to alleviate pressures on correspondent-respondent business relationships in the current unusual financial market environment. The amendments ensure that correspondents ineligible to receive interest on their own balances at Reserve Banks pass back to their respondents interest earned on required reserve balances held on behalf of those respondents. These amendments become effective 30 days after publication in the Federal Register.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

THE WINDOW REOPENS FOR CPP

Treasury Secretary Geithner announced that the Treasury will re-open the Capital Purchase Program ("CPP") application

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Credit Card Report

CREDIT CARD ACT

On May 22, the credit card world changed. President Obama signed into law a credit-card consumers' "Bill of Rights." The law (1) in the first year after a credit card account is opened, prohibits universal default on existing balances and increases in rates; requires promotional rates to last at least 6 months; (2) prohibits interest charges on paid-off balances from previous billing cycle (double-cycle billing ban) and late fees if the card issuer delayed crediting the payment; (3) prohibits certain fees to make payments, and over-limit fees unless the cardholder elects to allow the issuer to complete over-limit transactions; (4) requires penalty fees to be reasonable and proportional to the omission or violation; (5) requires fairness in the application and timing of payments; (6) protects students and other young consumers from aggressive credit card solicitations; (7) requires greater disclosure of rates, terms, and billing details by credit card companies such as requiring 45-days' notice of interest rate, fee, and finance charge increases, disclosures to consumers upon card renewal when the card terms have changed, and disclosures of the period of time and total interest it will take to pay off the card balance if only minimum monthly payments are made; (8) establishes tougher penalties for TILA violations; and (9) requires all gift cards to have at least a five-year lifespan and eliminates the practice of declining values and hidden fees for those cards not used within a reasonable time period.

Meanwhile, credit-card companies are reeling from record default rates. Losses may exceed 10 percent this year, setting a record.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

CREDIT CARD DISCLOSURES

On April 21, FRB, OTS, and NCUA proposed clarifications to their December 2008 final rules under the FTC Act prohibiting certain unfair credit card practices. FRB also proposed clarifications to its December 2008 final rule under TILA amending Reg Z to improve the disclosures consumers receive in connection with credit card accounts and other revolving credit plans. These proposals are intended to resolve areas of uncertainty and make technical corrections to ensure that institutions are able to come into compliance with the rules on or before the July 1, 2010. Key protections in the final rules would continue to apply to balances on a consumer credit card account when the account is closed or acquired by a different institution or when the balances are transferred to another account issued by the same institution. Comments on the proposals must be submitted within 30 days after publication in the Federal Register, which is expected shortly.

For more information, contact Obrea Poindexter at opoindexter@mofo.com.

THE LEFT COAST IN LEFT FIELD

Last year, the Ninth Circuit held Reg Z did not require a credit card issuer to provide additional notice of a default rate increase as long as the cardholder agreement specified the circumstances constituting default and the maximum default rate. That was then, this is now. In *McCoy v. Chase Manhattan Bank USA, N.A.*, 559 F. 3d 963 (9th Cir. 2009), another Ninth Circuit panel said otherwise, and its decision trumps the earlier one because this panel chose to publish its opinion. Judge Cudahy from the Seventh Circuit, sitting by designation, issued a blistering dissent. A rehearing petition is pending, based in part on the earlier Ninth Circuit opinion and on the Seventh Circuit's ruling reaching a contrary result. The Seventh Circuit considered and rejected the conclusions reached by the *McCoy* panel in denying plaintiff's petition for rehearing. *Swanson v. Bank of America, N.A.*, 559 F.3d 653 (7th Cir. 2009), *reh'g & reh'g en banc denied with opinion*, 2009 WL 1098756 (April 24, 2009). The First Circuit also rejected state law claims based on the same allegations, affirming the district court's dismissal of the claims as preempted by HOLA and OTS regulations. *Yeomalakis v. FDIC as Receiver for Washington Mutual Bank*, 562 F.3d 56 (1st Cir. 2009). ■

For more information, contact Bob Stern at rstern@mofo.com or Nancy Thomas at nthomas@mofo.com.

Preemption Report

YOU'RE OUTTA HERE!

State court that is. A district court in Los Angeles ruled in two separate cases that state law contract and tort claims were completely preempted by TILA and OTS regulations. *Salgado v. Downey Sav. & Loan Assoc.*, No. CV 09-1771, 2009 WL 960777 (C.D. Cal. Apr. 6, 2009); *Sartain v. Aurora Loan Serv's, LLC*, No. CV 09-1789, 2009 WL 950946 (C.D. Cal. Apr. 6, 2009). Plaintiffs in both cases filed suit against federal thrifts alleging failure to disclose important information about their home loans. The court relied on the OTS regulations expressly preempting certain state law claims as well as the Ninth Circuit's decision in *Silvas v. E*Trade* in holding plaintiffs' claims "necessitate a determination of federal law," so the defendants met their burden of establishing federal court jurisdiction.

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

CLEAR AS MUD

State law claims for defamation and outrageous conduct survived FCRA preemption because the plaintiff in each case alleged the information furnisher acted with malice. *Llewellyn v. Shearson Fin. Network, Inc.*, No. 08-cv-00179, 2009 WL 890705 (D. Colo. Mar. 31, 2009); *Earhardt v. Countrywide Bank, FSB*, No. 3:08-CV-238, 2009 WL 500838 (W.D.N.C. Feb. 25, 2009). The courts noted that the narrower of the two FCRA preemption provisions, arguably conflicting, provided an exception for defamation-like claims if malice is alleged. Both courts rejected the furnisher's argument that the broader preemption provision barred these claims, finding persuasive decisions of other courts had held that this provision applies only to statutory claims or to claims based on failure to correct mistaken information after receiving notice, and not to claims challenging initial furnishing of information.

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

THE NEXT TARGET

FDIC Chairman Sheila Bair clearly knows her audience. In testimony before the Senate Banking Committee, she used a hearing about the need for an independent financial product safety commission (which sounds scary enough) to state her view that Congress should consider curtailing federal preemption of state consumer protection statutes. She suggested the proposed commission could review state UDAP statutes and determine an appropriate floor for consumer protection. Just proves the old adage that things can always get worse. ■

For more information, contact Oliver Ireland at oireland@mofo.com.

Operations Report

Our Beltway Report was starting to resemble a Disease-of-the-week TV movie, so we thought we'd move at least some of the bad news to our Operations Report.

LIGHTEN UP

Treasury Secretary Timothy Geithner called for major changes in compensation practices at financial companies and said the Administration's plan to realign pay with performance will be rolled out by mid-June. He noted that very substantial changes are expected in this regard, while noting that Wall Street's pay practices, including big year-end bonuses, encouraged excessive risk-taking and helped precipitate the financial crisis. He noted a set of broad standards financial supervisors can use is needed to ensure that does not happen again.

SPIN CYCLE

On May 7, 2009, the long-awaited results of a comprehensive, assessment of the financial conditions of the nation's 19 largest bank holding companies were released. The exercise conducted by FRB, the OCC, and the FDIC was not a test of solvency but a forward-looking "what-if" exercise intended to help supervisors gauge the extent of the additional capital buffer necessary to keep these institutions strongly capitalized and lending, even if the economy performs worse than expected between now and the end of next year. The study found that nearly all the banks evaluated have enough Tier 1 capital to absorb the higher losses envisioned under the hypothetical adverse scenario but roughly half the firms need to enhance their capital structure to put greater emphasis on common equity, which provides institutions the best protection during periods of stress.

FDIC ASSESSMENT

On May 22, the FDIC set a special assessment at 5 basis points on each insured depository institution's assets minus its Tier 1 capital as reported in the report of condition of June 30, 2009, and collected on September 30, 2009. The FDIC will cap the special assessment at 10 basis points times the institution's assessment base for the second quarter of 2009 risk-based assessment. ■

Mortgage Report

FAIR LENDING UPDATE

These cases continue to move along, but not at a lightning pace. In *NAACP v. Ameriquest*, the first of the fair lending cases, Judge Guilford recently entered a significant bifurcation order. For defendants who are no longer engaged in the challenged lines of business/business practices—subprime lending and underwriting ARM loans to teaser rates—Judge Guilford limited the first phase of discovery to whether the NAACP's request for injunctive relief, the only relief sought in the case, is viable. Briefing on the issue is scheduled to commence in late July, and the industry can hope to have a decision on this case-dispositive issue sometime this fall.

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

OPTION ARM LITIGATION

The results have been coming in from the district courts with option ARM cases, and they have been mixed. On the plus side, the classwide claims for rescission are largely disappearing. Defendants have also had success in disposing of state-law-based fraud claims. The TILA claims have been more difficult. That said, Judge Stotler, who has a number of option ARM cases pending before her in the Central District of California, has rejected each of plaintiffs' theories, including the TILA theories. *See, e.g.*, *Carroll v. Homecomings Financial*, No. 07-3775. In response, plaintiffs' counsel have been settling and dismissing all of their cases that are in front of Judge Stotler.

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

RESPA STANDING

Standing, and particularly whether Article III requires proof of economic injury for Section 8 claims, continues to be a hot topic. Those who favor recreational use of the courts recently scored a victory in the Sixth Circuit in *In Re Carter*, 553 F.3d 979 (6th Cir. 2009). In the title insurance context, the court held that allegations of an overcharge were not necessary, as RESPA confers "an individual right to receive referral services untainted by kickbacks or fee-splitting," the violation of which, standing alone, is sufficient to confer standing. *Id.* at 989. The same issue is currently being presented to the Third Circuit in the captive reinsurance litigation in *Alston v. Countrywide*, No. 08-4334, where briefing is set to conclude by the end of the summer.

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

FCRA CREDIT SCORE DISCLOSURE LITIGATION

Now that "firm offer" litigation is kaput, another type of FCRA litigation looms: credit score disclosures. Under FACTA, if a lender uses an applicant's credit score, it must provide that applicant with a credit score disclosure "as soon as reasonably practicable." 15 U.S.C. § 1681g(g). With no formal guidance on the timing standard, this type of litigation could become a hotbed for the plaintiffs' bar. Currently, there are a handful of cases pending in the Eastern and Western Districts of Virginia, with *Yarish v. Downey Financial Corp.*, No. 08-380 (E.D. Va., filed June 19, 2008), firing the opening salvo. *Yarish* moved beyond the pleadings stage on April 28, 2009, with the district court denying a motion to dismiss. *Yarish* seeks to certify a nationwide class of mortgage applicants who were not provided with credit score disclosures at all or not provided with such disclosures before loan closing.

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

MUNICIPALITIES ISO REVENUE

On April 20, the Atlanta City Council passed a resolution setting the stage for any lawsuits this city could pursue against subprime lenders for allegedly causing the foreclosure crisis hitting its neighborhoods. Atlanta will hire a private law firm to examine whether there are any grounds to sue lenders for alleged practices believed to have helped Georgia gain the seventh highest foreclosure rate in the nation for Q1 2009. According to the city, foreclosures rose in metro Atlanta by 42 percent from 9,334 to 13,292 between 2006 and 2008. Atlanta joins several other big cities that have considered holding financial institutions responsible for rising foreclosures. Lawsuits by municipalities have moved forward in Baltimore, Buffalo, and Birmingham, to name a few. Meanwhile, Cleveland's public nuisance suit against 21 financial institutions was booted out of federal district court on May 15. Judge Lioi dismissed the complaint, most notably holding that the public nuisance claim was preempted by Ohio lending laws and that securitizing subprime loans did not proximately cause the alleged damages of decreased tax revenue and increased expenditures.

For more information, contact Wendy Garbers at wgarbers@mofo.com.

MORTGAGE REFORM MEASURE

On May 7, the House of Representatives passed the Mortgage Reform and Anti-Predatory Lending Act of 2009 (H.R. 1728). The bill attempts to reform the lending practices viewed as playing a major role in the subprime mortgage meltdown. Key features would require creditors to offer "appropriate" loans to consumers who have a reasonable ability to repay, or, for refinancings, that provide consumers with a "net tangible benefit." Creditors must make loans based on a good faith determination of the above. Certain "qualified mortgages" fall into a safe harbor and would be presumed compliant: 30-year fixed rate prime loans, as well as some ARMs and higher rate loans with limited fees. To keep "skin in the game," federal regulators would have flexibility to require lenders making non-qualified loans to retain some of the loans' risk even if they are sold in the secondary market. The bill would allow state AGs to enforce the above federal standards.

For more information, contact Joe Gabai at jgabai@mofo.com.

BAILOUTS "R" US, THE SEQUEL

On March 4, the White House launched its plan for mortgage modifications through the much-anticipated Making Home Affordable ("MHA") program. Among other things, the MHA implemented financial incentives for lenders to modify existing first mortgages and provided standardized guidelines for mortgage modifications across the industry.

More recently, on April 28, the Obama administration expanded MHA to also help 1 to 1.5 million troubled homeowners modify second mortgages. The Second Lien Program (SLP) includes: (1) cost sharing between the MHA and lenders to reduce homeowners' payments for second mortgages; (2) financial incentives for servicers and borrowers; and (3) a payment schedule to compensate lenders for extinguishing second mortgages. Moreover, the SLP will facilitate automatic modification of a second lien when a first lien is modified by participating servicers. For a comprehensive overview of mortgage modification and foreclosure mitigation efforts, see our recent news bulletin: http://www.mofo.com/news/updates/files/090306RearView.pdf. ■

For more information, contact Joe Gabai at jgabai@mofo.com.

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Privacy Report

A GOOD DELAY

The FTC's Red Flag rules were scheduled to go into effect on May 1, 2009, but on April 30, 2009, the FTC announced that it would delay enforcement of the rules until August 1, 2009, to give creditors and financial institutions more time to develop and implement written identity theft prevention programs. The announcement does not affect other federal agencies' enforcement of the original November 1, 2008, compliance deadline for institutions subject to their oversight such as users of consumer reports and issuers of debit and credit cards. FTC Chairman Jon Leibowitz indicated that this delay may also be used to give Congress the opportunity to revisit the scope of the Red Flags Rule. To help entities with low identity theft risk, such as those that know their customers personally, the FTC has also created a template guiding such businesses and organizations in developing written identity theft prevention programs to comply with the Red Flags Rule.

For more information, contact Andrew Smith at asmith@mofo.com.

MODEL PRIVACY NOTICE COMMENT PERIOD REOPENS AND ENDS

The SEC reopened the period for public comment on a model privacy notice (the "Model Notice") that financial institutions could use to provide disclosures in accordance with the privacy notice provisions of the Gramm-Leach-Bliley Act (the "GLBA"). During the first year after adoption, both the Model Notice and the sample clauses for privacy notices provided in Reg. S-P would serve as safe harbors under GLBA but, after the first year, the Model Notice will be the sole safe harbor available. The comment period was reopened to allow public comment on the results of consumer testing of the types of privacy notices, which became available subsequent to the initial comment period. The reopened comment period ended May 20, 2009.

For more information, contact Andrew Smith at asmith@mofo.com.

COMING SOON: MORE PRIVACY REGULATION

In May, Acting Director of the FTC's Bureau of Consumer Protection said the agency strongly supports the goals of H.R. 2221, the Data Accountability and Trust Act, which would require companies to put reasonable data security policies and procedures in place, and to notify consumers when there has been a data security breach that affects them. The legislation would give the Commission authority to obtain civil penalties for violations and undertake enforcement actions against practices it deems harmful to consumers, irrespective of whether such practices are unfair or deceptive. The Commission recommended that the legislation be extended to cover data stored on paper and that provisions imposing obligations on information brokers be targeted specifically to address consumer harm when brokers sell information.

PRACTICE WHAT YOU PREACH

The FTC approved an alternative procedure for the production of customer information in connection with the FTC's study on the effect of credit-based insurance scores on the availability and affordability of homeowner's insurance. In December 2008, the Commission issued orders requiring the nine largest private providers of homeowner's insurance to produce information for the study, including policyholder data, by submitting data and documents containing consumers' personally identifiable information ("PII") to a third party(ies) selected by the FTC. The third parties must now certify that their data security practices will protect the data they receive. This procedure responds to concerns that some state laws may require insurance companies to remain responsible for the PII of their policyholders. Companies choosing to use the alternative procedure will send their data and copies of documents to the FTC with an associated unique identifying number without any PII such as policyholder name, street address, Social Security number, or date of birth.

For more information, contact Andrew Smith at asmith@mofo.com.

SEARS PRIVACY CLASS ACTION CERTIFIED

On April 7, an Illinois state court in Chicago certified a plaintiff class in lawsuits alleging that customers' personal, private, and confidential financial information was disclosed for profit by Sears to certain third-party vendors contrary to the representations and obligations to its credit card holders. The class includes persons who, between September 9, 1995, and June

22, 2001, were Sears credit card customers and had certain information (name, address, telephone number and scrambled or unscrambled credit card number) disclosed by Sears to a third-party vendor, Memberworks, Cendent, Encore Marketing and/or Allstate Motor Club, with whom Sears had an agreement to disclose certain information, and pursuant to which Sears was entitled to receive money, directly or indirectly, as a result of any sales of goods, programs, or services by the third-party vendor to Sears credit card holders or through an administrative, service or transactional fee. ■

California Report

We wish the expression "only in California" hadn't become so clichéd, but there are times when nothing less will do. This is such a time.

BANGING OUR SPOON AGAINST THE HIGH CHAIR

On May 18, the California Supreme Court got its chance in *In re Tobacco II Cases* to decide what the voters of California meant when they enacted Proposition 64, the November 2004 initiative that sought to curtail the abuses in California's unfair competition law. But a 4-to-3 decision in this case, suggests that the California courts are not yet ready to view class action procedure the way other states and the federal courts do.

The Court held that Proposition 64's "standing requirements are applicable only to the class representatives, and not all absent class members." In a vigorous dissent, Justice Baxter wrote that this "turns class action law upside down and contravenes the initiative measure's plain intent." On a second issue, the court held that the "as a result of" requirement "imposes an actual reliance requirement on plaintiffs prosecuting a private enforcement action under the UCL's fraud prong." But the majority went on to impose several limitations on this requirement. One California plaintiff's lawyer has already noted that "the showing required now is exactly the same as what it was pre-Prop. 64," that "[i]ndividualized proof of deception, reliance and injury are not required, and that "[a]fter Tobacco, class certification of a UCL claim now should be as easy … as it was before Prop. 64."

For more information, contact Will Stern at wstern@mofo.com.

OH, REALLY

A week later, an intermediate California appellate court held, in a case of first impression, that a trial court can order restitution under California's unfair competition law and then treble it if the action is brought "for the benefit of senior citizens or disabled persons." The trial court refused to permit trebling but the appellate court reversed, citing *Tobacco II Cases* for the proposition that to the extent this furthers deterrence, that is all the more reason why this reading is right. ■

For more information, contact Will Stern at wstern@mofo.com.

Arbitration Report

THE SUPREMES ISSUE PRO-ARB OP

In *114 Penn Plaza LLC v. Pyett*, 2009 WL 838159 (2009), the U.S. Supreme Court held that a union can sign a collective bargaining agreement with an employer that compels individual union members to arbitrate their claims against the employer. Following the framework in *Gilmer v. Interstate Johnson Lane Corp.*, 500 U.S. 20 (1991), the Court determined that an agreement to arbitrate should be enforced as a matter of contract law unless Congress "has evinced an intention to preclude a waiver of judicial remedies for the statutory rights at issue." Finding that the ADEA, under which the claims had been brought, did not explicitly preclude arbitration, the Court held that as long as the union and the employer bargained in good faith for the arbitration provision, federal courts must enforce that agreement.

For more information, contact Rebekah Kaufman at rkaufman@mofo.com.

MUTUALITY OF WAIVER CAN'T BE ILLUSORY

The Ninth Circuit refused to enforce a class action waiver in T-Mobile's service agreement on the ground that the mutuality of the waiver was illusory: "T-Mobile's waiver is unilateral in effect[.] It can hardly be imagined that T-Mobile or its suppliers would ever want or need to bring a class action against T-Mobile's customers." *Chalk v. T-Mobile USA, Inc.*, No. 06-35909 (9th Cir. Mar. 27, 2009). The plaintiffs filed the putative class action against T-Mobile in 2006, alleging that T-Mobile had wrongfully contracted with IBM ThinkPad owners to provide service for a wireless Internet PC card that was incompatible with ThinkPads. The Ninth Circuit refused to sever the class action waiver from the arbitration agreement in which it was contained because the agreement contained a provision prohibiting severance of the waiver.

For more information, contact Rebekah Kaufman at rkaufman@mofo.com.

WAIVER UPHELD IN PAYDAY LOAN CASE

A federal court in Arkansas upheld a class action waiver and compelled arbitration in a putative class action alleging that two payday lenders charged usurious fees in violation of the Arkansas Constitution. *Easter v. VS Financial of Arkansas, LLC*, Case No. 08-CV-1041 (W.D. Ark. 2009). The court rejected plaintiffs' argument that the arbitration agreement was unconscionable, finding that plaintiffs had not made any assertions of procedural unconscionability and that it would not be prohibitively expensive for plaintiffs to bring their claims individually in arbitration. The arbitration agreement required defendants to pay for any arbitration fee up front, and plaintiffs would only be responsible for refunding payment to defendants if plaintiffs were unsuccessful in arbitration.

For more information, contact Rebekah Kaufman at rkaufman@mofo.com.

UNILATERAL MODIFICATION CLAUSE INVALIDATES ARBITRATION AGREEMENT

On April 15, 2009, a Texas federal district court held that an arbitration provision in Blockbuster's online terms of service was "illusory" and unenforceable because Blockbuster had reserved the right to change the terms of service at any time. *Harris v. Blockbuster Inc.*, No. 3:09-cv-217-M (N.D. Tex. April 15, 2009). The court expressed concern that nothing in Blockbuster's Terms and Conditions of Use expressly prevented Blockbuster from making modifications to the arbitration provision and applying the modified terms to earlier disputes, and rejected Blockbuster's argument that it was not actually trying to apply a modified arbitration provision to a prior claim. The decision is surprising in that, based only on the presence of the unilateral modification clause, the court invalidated an arbitration provision that the user clearly agreed to when she clicked the box during Blockbuster's online registration process. If followed by other courts, the *Harris* decision could have significant implications not only for website operators, but also for any company that wishes to retain the right to modify its standard terms retroactively for existing customers.

For more information, contact Rebekah Kaufman at rkaufman@mofo.com.

ARBITRATION CLAUSE CAN'T BE ADDED VIA BILL STUFFER

The Montana Supreme Court has refused to enforce an arbitration provision that was added to a credit card agreement through a bill stuffer included in the cardholder's billing statement. *Kortum-Managhan v. Herbergers NBGL*, No. DA 06-0566 (Mont. Mar. 17, 2009). The court differentiated between changes in the financial terms and rates of a credit card agreement and the inclusion of completely new provisions that could affect constitutional rights, finding that a cardholder could not be deemed to have knowingly waived her constitutional right to a jury trial when that waiver was effectuated through a bill stuffer. "[M]aking a change in a credit agreement by way of a 'bill stuffer' does not provide sufficient notice to the consumer on which acceptance of the unilateral change to a contract can be expressly found." ■

For more information, contact Rebekah Kaufman at rkaufman@mofo.com.

The firm members who specialize in financial services are:

San Francisco

Michael Agoglia	(415) 268-6057	magoglia@mofo.com
Roland Brandel	(415) 268-7093	rbrandel@mofo.com
Greg Dresser	(415) 268-6396	gdresser@mofo.com
Wendy Garbers	(415) 268-6664	wgarbers@mofo.com
Rebekah Kaufman	(415) 268-6148	rkaufman@mofo.com
Adam Lewis	(415) 268-7232	alewis@mofo.com
Jim McCabe	(415) 268-7011	jmccabe@mofo.com
James McGuire	(415) 268-7013	jmcguire@mofo.com
Andrew Muhlbach	(415) 268-7221	amuhlbach@mofo.com
William L. Stern	(415) 268-7637	wstern@mofo.com

New York

Jack Auspitz	(212) 468-8046	jauspitz@mofo.com
James Bergin	(212) 468-8033	jbergin@mofo.com
Chet Kerr	(212) 468-8043	ckerr@mofo.com
Mark Ladner	(212) 468-8035	mladner@mofo.com
Barbara Mendelson	(212) 468-8118	bmendelson@mofo.com
Anthony Radice	(212) 468-8020	aradice@mofo.com
Joan Warrington	(212) 506-7307	jwarrington@mofo.com

Washington, D.C./Northern Virginia

Steve Colangelo	(202) 887-1528	scolangelo@mofo.com
L. Richard Fischer	(202) 887-1566	lfischer@mofo.com
Oliver Ireland	(202) 778-1614	olreland@mofo.com
Obrea Poindexter	(202) 887-8741	opoindexter@mofo.com
Andrew Smith	(202) 887-1558	asmith@mofo.com

Los Angeles

David Babbe	(213) 892-5549	dbabbe@mofo.com
Henry Fields	(213) 892-5275	hfields@mofo.com
Joseph Gabai	(213) 892-5284	jgabai@mofo.com
Mark Gillett	(213) 892-5289	mgillett@mofo.com
Dave McDowell	(213) 892-5383	dmcdowell@mofo.com
Robert Stern	(213) 892-5484	rstern@mofo.com
Nancy Thomas	(213) 892-5561	nthomas@mofo.com
Donna Zenor	(213) 892-5443	dzenor@mofo.com

Denver

Steven M. Kaufmann	(303) 592-2236	skaufmann@mofo.com

Sacramento

Michael Stusiak	(916) 325-1306	mstusiak@mofo.com

If you wish to change an address, add a subscriber, or comment on this newsletter, please write to:
Siobhan Guthrie
Morrison & Foerster LLP
425 Market Street
San Francisco, California 94105
sguthrie@mofo.com

www.mofo.com

Beltway Report

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window for banks with total assets under $500 million and raise (from 3% to 5% of risk-weighted assets) the amount for which qualifying institutions can apply. The application window is reopened for all term sheets, and current CPP participants may reapply and will benefit from an expedited approval process. The Treasury will also extend the deadline for small banks to form a holding company for the CPP purposes. Both windows will remain open for six months. The expectation is that funding for these additional CPP capital investments will come from repayments expected from some of the largest banks.

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SOME REPRIEVE … AT LAST

The FRB issued a final rule delaying from March 31, 2009, until March 31, 2011, the effective date of new limits on BHC risk-based capital calculations. The delay is due to the continuing stress in the financial markets and is meant "to promote financial stability in the financial markets and the banking industry as a whole." This delay allows BHCs to continue holding cumulative perpetual preferred stock and trust preferred securities in their Tier 1 capital equaling up to 25% of a BHC's total core capital elements. ■

Newsletter Staff

William L. Stern, Editor-in-chief

Ana-Maria Ignat, Managing Editor
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(California Report)

Andrew M. Smith, Editor
(Privacy)

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