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Financial Services Report, Spring 2008

March 2008

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Financial Services Report, Spring 2008

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In this issue:

Editor's Note

It is time to play pin the blame on the subprime crisis. Half of all observers blame Greed, another half blame Wall Street, and the third half say that's redundant. Baltimore blames Wells Fargo Bank, and not just for the subprime crisis either . . . also urban decay, youth gangs, drugs, bad posture, and Paris Hilton's new movie. We have our own plan, which is to lay all this at the doorstep of Alan Greenspan, ring the doorbell, and run.

The press wallow in gloom, which means that the positive aspects of the subprime crisis are getting overlooked. Our Top Three: (i) Fewer Hummers straddling two parking spaces; (ii) easier to get a power table at Per Se; and (iii) when was the last time you heard a noisy radio ad from a mortgage broker?

I have a confession to make. It's my fault. My name is Jérôme Kerviel. You may say that I exposed Société Générale to $70 billion in potential losses, but mon dieu! Look at the bright side, être optimiste. How many of you go to Las Vegas and lose only 10%? Excuse moi, but just one more jack of spades and Bernanke would have been serving me foie gras by the tonneau.

Spit out your gum and sit up straight. Lots of stuff happened this quarter. The hot ticket is the subprime crisis, which is playing to packed houses in Congress. Capitol Hill will be a battleground over bills to revamp mortgage underwriting standards, force lenders to engage in loan mitigation, and impose caps on interchange fees. The state legislatures have seized the privacy initiative, with five states moving legislation that would make merchants liable to banks for mass data compromise. RESPA litigation took a plot twist in the Eleventh Circuit. Preemption was also a big deal, and this quarter business took care of business.

Until next time, don't forget . . . there's an elf in self and a mug in smug.

William L. Stern, Editor

MoFo Metrics

59	Percentage of Americans who can name The Three Stooges
17	Percentage of Americans who can name three Supreme Court Justices
10.3	Percentage of US homeowners whose mortgages exceed home value
6	Number of videos rented daily in the US, in millions
3	Number of public library items checked out daily in the US, in millions
4	The cost, in cents, to print a dollar bill
7	Number of countries to emerge from Yugoslavia

Beltway Report

The Twenty-Eighth Amendment
Anything called the "Credit Cardholders' Bill of Rights" can't be good for card issuers. On February 7, Representative Carolyn Maloney (D-N.Y.) introduced H.R. 5244. It would: (1) allow cardholders to cancel cards when their interest rate increases, while paying off existing balances at the previous rate; (2) prohibit retroactive rate increases on existing balances; (3) ban collecting interest on amounts already paid; (4) require payments to be allocated among balances with differing rates; and (5) require payments made by 5 p.m. EST on a bill's due date to be credited for that day.

Meanwhile, Chairman Ben Bernanke announced on February 28 that the FRB would issue its credit card disclosure practices rule this spring, perhaps along with its unfair and deceptive practices rule (*see* next item, "Wedged In"). That might take some steam out of this locomotive.

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

Wedged In
Some childhood memories linger: a first wedgie, for example. The subprime crisis may be like that. Long after the crisis is over, the industry will still be walking funny.

The Federal Reserve Board, prodded on by Rep. Barney Frank, has given the first tug. It published a notice of proposed rulemaking amending Reg Z covering unfair or deceptive home mortgage lending and advertising practices. The proposal provides for special protections for "higher-priced mortgage loans" and for all closed-end mortgage loans and imposes advertising requirements and early disclosures for non-purchase money mortgage closed-end loans. For higher-priced mortgage loans, creditors would be barred from extending credit without considering the borrowers' ability to repay the loan and would have to verify the income and assets relied upon in making the loan, and prepayment penalties could not apply for at least 60 days before any possible payment increase. Other protections apply to all loans secured by a consumer's principal dwelling, regardless of the APR, and deal with yield-spread premiums, real estate appraisals, rates, and payment disclosure in equal prominence to introductory or "teaser" rates, goodfaith estimates of loan costs, and fees charged before receipt of early disclosures. Comments on the proposal are due by April 8, 2008.

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

Interchange Wars
Thirty-six billion. That is the estimated amount of revenue generated annually by interchange fees. At least a few members of Congress think that may be too much, and House and Senate Judiciary Committee members on both sides of the aisle are drafting legislation to regulate interchange fees. In the last few years, hearings

have been held, but the action was limited to commissioning studies into how interchange fees are set. The GAO is currently investigating.

That may change. A draft bill that would impose a form of price control was leaked in mid-February. Although it has not yet been introduced, it would create a three-person board appointed by the FTC and the FRB to regulate interchange fees. The legislation is based on a copyright royalty statute that many believe is a failure even in a less complex context. The initiative is the result of intense lobbying. Merchants want to see discount fees reduced and are waging campaigns at the federal and state levels to get that done. Eighteen states have interchange-fee legislation pending.

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

Size Matters
Effective January 1, 2008, the thresholds used to define "small bank," "small savings association," "intermediate small bank," and "intermediate small savings association" under the Community Reinvestment Act (CRA) have changed as a result of the 2.7% increase in the Consumer Price Index (CPI) for Urban Wage Earners and Clerical Workers for the period ending in November 2007. "Small bank" or "small savings association" now means an institution that, as of December 31 of either of the prior two calendar years, had assets of less than $1.061 billion, and "intermediate small bank" or "intermediate small savings association" an institution with assets of at least $265 million as of December 31 of both of the prior two calendar years, and less than $1.061 billion as of December 31 of either of the prior two calendar years.

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

HMDA Threshold
The Federal Reserve Board published the annual notice of the asset-size exemption threshold for depository institutions under Regulation C, which implements the Home Mortgage Disclosure Act (HMDA). Effective January 1, 2008, the asset-size exemption for depository institutions increased from $36 million to $37 million based on the annual percentage change in the Consumer Price Index for Urban Wage Earners and Clerical Workers for the twelve-month period ending in November 2007. Depository institutions with assets of $37 million or less as of December 31, 2007, are exempt from collecting HMDA data in 2008, which does not affect their responsibility to report the data they were required to collect in 2007.

No ILC Moratorium Extension
The FDIC did not extend the 18-month industrial loan company ("ILC") moratorium, which ended on January 31, 2008, and no definite Congressional action was taken before its expiration. Last year, the House passed an "anti-Wal-Mart" bill to restrict commercial ownership of ILCs, but the Senate never acted and might have even less incentive to act now that the highly controversial application of Wal-Mart and the noncontroversial application of The Home Depot have been withdrawn. Since he is no longer running for President, Senator Chris Dodd promised to get the ILC legislation moving, but Sen. Robert Bennett strongly opposes the legislation. (Most ILCs are chartered in Utah.)

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

Truth in Landing
The FDIC may be getting jitters. It just issued a two-part notice of proposed rulemaking relating to the potential failure of an insured depository institution. Part 1 governs how and when deposit account balances would be determined in the event of a failure. Part 2 is intended to allow the deposit operations of a failed large depository institution to continue on the day following the failure. This is the third FDIC notice of proposed rulemaking on this subject and reflects comments received by the FDIC in response to its 2005 and 2006 notices. Public comments on this proposal are due by April 14, 2008.

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

Ahead of the Summons

Make a Loan … Underwrite Urban Renewal
Foreclosures are sky high, and that's just Michael Jackson's Neverland. Too bad he doesn't live in Baltimore, which has resolved to fix the subprime crisis its own way. Baltimore reckons that Wells Fargo is responsible for the subprime crisis—and also for urban decay, street gangs, youth violence, and bad schools. The

Baltimore lawsuit alleges that Wells Fargo Bank engaged in a pattern of predatory lending practices (reverse redlining) in Baltimore's poorest neighborhoods, leading to foreclosure rates nearly double the citywide average.

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

Cleveland v. Wall Street

Is lending money a nuisance? Many bankers are probably starting to think so. But now, so does Wall Street. Within days of the Baltimore lawsuit, Cleveland sued twenty-one Wall Street firms—the major securitizers of subprime mortgages—on a nuisance theory over their role in securitizing subprime loans on properties located in Cleveland. The city seeks damages for the negative impact on property values that has diminished city tax collections. *Clevelandv. Deutsche Bank Trust Co., et al.*, Cuyahoga County, Case No. Cv 08 646970. The Complaint says that defendants are liable "for public nuisance for their respective roles in proliferating *toxic* subprime mortgages within its borders, under circumstances that made the resulting spike in foreclosures a foreseeable and inevitable result." In Cleveland, mortgages are contaminants.

Remembrance of things past? These municipal lawsuits are reminiscent of the lawsuits brought a decade or more ago in which cities sued tobacco companies and gun manufacturers for expenses associated with having to treat lung cancer and shooting victims. Those suits fizzled. Still, other cities hurt by the subprime crisis are likely to watch this litigation closely.

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

The Buckeye-neer State

What is it with Ohio? In January, the Ohio Attorney General filed a securities fraud class action lawsuit against Freddie Mac, alleging that it misrepresented that it is engaged in the low-risk prime mortgage transactions, while concealing the extent of its purchase of high-risk subprime loans, guarantees of subprime loans, and securities backed by subprime mortgages. The suit is brought on behalf of the Ohio Public Employers Retirement System, which alleges that its losses could be as high as $27.2 million.

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

The Other Option ARM Option—Sue

In January, a California class action plaintiffs' lawyer sued more than a halfdozen mortgage lenders all on the same day for alleged violations of the Truth in Lending Act. The complaints allege that defendants sold to class members a PayOption Adjustable Rate Mortgage that would allow borrowers to choose a very low payment rate for up to five years, but the claim is that the interest rate used to calculate the payment schedule was not the rate stated in the loan documents and that borrowers would incur negative amortization if they followed the payment schedule. This is in addition to the 31-plus Option ARM class actions filed last year.

These cases seek classwide rescission under TILA, a prospect that many thought was dead, but that a district court in Wisconsin revived last year in *Andrews v. Chevy Chase Bank, FSB*, 474 F. Supp. 2d 1006, 1007 (E.D. Wis. 2007). *Andrews* is on review to the Seventh Circuit.

For more information, contact Michael Agoglia atmagoglia@mofo.com.

Just in Time

Roger Clemens has nothing on the US Supremes, who delivered high heat at the heads of the plaintiffs' bar and also sent a message to lawyers waiting on deck. In *Stoneridge Investment Partners LLC v. Scientific-Atlanta Inc.*, No. 06-43, 552 U.S. ___ (January 15, 2008), the Supreme Court ruled that secondary actors cannot be liable to private plaintiffs under the federal securities laws for statements made by others. What the Court said about so-called "scheme" liability should come as welcome news to Wall Street and those suppliers, business partners, accountants, banks, lawyers, and others who conduct business with and work for public companies that are sued by shareholders.

In *Stoneridge*, the plaintiff investors sued Charter Communications, Inc. for violations of Section 10(b). The plaintiffs also sued certain suppliers of Charter, including, among others, Scientific-Atlanta and Motorola. The plaintiffs claimed that the suppliers engaged in a scheme with Charter to defraud Charter's shareholders by entering into unlawful agreements with the suppliers whereby Charter overpaid for "set top" boxes and other hardware. In exchange for this overpayment, the suppliers agreed to purchase advertising from Charter. Charter then recorded the advertising purchases as revenue, artificially inflating the total revenue that Charter reported to the market.

The Supreme Court held that "scheme" claims are not viable. The suppliers had no affirmative duty to disclose anything to Charter's shareholders. It also held that the suppliers' alleged conduct was "too attenuated" because investors did not know about the suppliers' conduct. It was Charter, not the suppliers, who "filed fraudulent financial statements," and nothing that the suppliers did "made it necessary or inevitable for Charter to record the transactions that it did."

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

Mind the Gap

In its annual report on securities class action filings, the Stanford University Law School Securities Class Action Clearinghouse reports that the significant upswing in securities class action filings in 2007 is largely attributable to the subprime mortgage meltdown. A copy of the full report can be viewed at http://securities.cornerstone.com/pdfs/YIR2007.pdf.

Privacy Report

New Jersey Data Security Rules on Hold

The cheer you heard in New Jersey wasn't only for the Super Bowl champion New York Giants. The NJ State Department of Consumer Affairs announced it would not adopt a proposal issued in April 2007 concerning data security. One onerous provision would have required notice to the state police "within six hours following discovery or notification of the breach." The Department announced that it will work with representatives from financial institutions, securities broker-dealers, and other businesses to develop new breach notification rules.

For more information, contact Miriam Wugmeister at mwugmeister@mofo.com.

Breach Notification Recapped

Only two states—New Mexico and South Dakota—do not have either a breach notification law on the books or a current bill pending to establish such a law. These laws started with California's, in 2003. The particular requirements vary, but, in general, an entity that "owns or licenses" data containing "personal information" may be required to notify the individual to whom that information relates about the security breach. In addition, under the notification laws of Hawaii, Louisiana, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, North Carolina, Puerto Rico, and Vermont, an entity may be required to notify certain regulators.

Recent developments: (1) An amended California law, effective January 1, 2008, covers two additional data elements of "personal information," namely, "medical information" and "health insurance information"; (2) A Maryland law, effective January 1, 2008, requires certain information about the Maryland Attorney General and the FTC to be included in a notice to individuals; and (3) The Massachusetts law, which became effective last October, provides that a notice to individuals must include the consumer's right to obtain a police report and how to request a security freeze (including necessary information and fees to be paid to do so), but not information about the "nature of the breach." That limitation on the information in a notice may prove problematic since companies generally include information about the nature of the breach in order to assist consumers in asessing the steps they may need to take, if any, in response to the particular incident.

For more information, contact Thomas Scanlon at tscanlon@mofo.com.

Caveat Merchant

Never put your finger in someone else's bowling ball. Good advice, that. And if you're a merchant, you should not store track and PIN data. As reported in these pages, starting August 2008, Minnesota will make a merchant liable to financial institutions if it stores certain sensitive card data after the transaction and if there is a security breach of the merchant's system.

In 2007, seven states considered retailer data breach liability bills in the wake of a massive data breach at retailer TJX Companies Inc. California passed a similar bill, but Governor Schwarzenegger vetoed it in October. Now, other states are looking to pass retailer-liability laws. A bill in Washington (H.B. 2838) that would make merchants liable to banks passed one chamber on February 15. New retailer-liability measures introduced in Alabama (S.B. 382), Iowa (S.S.B. 3200), and Wisconsin (H.B. 745) also seek to hold merchants liable to financial institutions for payment card breach costs. Michigan is considering such a bill. A bill recently reintroduced in New Jersey (A. 2270) would make every entity covered by the state's existing data breach notification law liable to banks for breaches of any protected personal information, not just retained payment card transaction data.

For more information, contact Miriam Wugmeister at mwugmeister@mofo.com.

California Report

What's New in 17-Two?
This quarter the California Supreme Court let stand two strong pro-defense cases testing Proposition 64, the reform measure that limited suits brought under California's unfair competition law, Bus. & Prof. Code § 17200. This is noteworthy, because until recently the high court had been taking review in every important Prop 64 case to date, rendering them uncitable. Now, two decisions have stood, and both are citable.

The first case, *Buckland v. Threshold Enterprises*, 155 Cal. App. 4th 798 (2007), holds that the purchase of a product for the sole purpose of establishing standing to sue is not "injury in fact" nor "loss of money or property" within the meaning of Proposition 64. The other, *Akkerman v. Mecta Corp.*, 152 Cal. App. 4th 1094 (2007), holds that under Proposition 64 "each class member would have to prove his individual claim for restitution by establishing reliance and causation." It concluded that individual issues would predominate, and affirmed the trial court's order denying class certification in a UCL case alleging deceptive advertising against the manufacturer of an electro-convulsive therapy machine.

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

SLUSA Slash
On January 25, an intermediate California appellate court threw out a securities class action case against Wells Fargo Bank. *Wells Fargo Bank, N.A. v. Superior Court*, ___ Cal. App. 4th ___, 2008 WL 204161 (Jan. 25, 2008). Plaintiffs alleged that the bank invested trust assets in proprietary mutual funds in order to maximize fees for itself and affiliates, and charged unreasonable fees for tax preparation. They brought their claims under California's unfair competition law. The court held that the Securities Litigation Uniform Standards Act of 1998, 12 U.S.C. § 78bb(f), applied, which meant that plaintiffs could not bring their UCL and other state law claims as a class action.

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

Operations Report

Just Between Us
The FRB issued a supervisory letter clarifying its expectations regarding confidentiality provisions in agreements between banking organizations supervised by the FRB and third parties. In particular, the letter states that it is contrary to FRB regulation and policy for third-party agreements to contain confidentiality provisions that: (1) restrict bank organizations from providing information to FRB supervisory staff; (2) require or permit, without the prior approval of the FRB, banking organizations to disclose to a counterparty that any information will be or was provided to FRB supervisory staff; or (3) require or permit, without the prior approval of the FRB, banking organizations to inform a counterparty of a current or upcoming FRB examination or any nonpublic FRB supervisory initiative or action.

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

Dancing Bank to Bank
The FDIC voted to amend its Statement of Policy on Bank Merger Transactions. The amendments would reflect changes to the Bank Merger Act made by the Financial Services Regulatory Relief Act of 2006 that eliminated the need for the FDIC to obtain a competitive factors report from the other three Federal banking agencies in processing a merger application and that eliminated both the post-approval Department of Justice waiting period and the need to obtain competitive factors reports when the proposed merger solely involves an insured depository institution and one or more of its affiliates. The amendments would also reflect the 2005 consolidation of the two former deposit insurance funds into one Deposit Insurance Fund, conform the description of the factors to be considered in evaluating a merger more closely to the Bank Merger Act, and revise the discussion of the evaluation of certain anticompetitive mergers involving failing banks. The Statement also provides that the FDIC must consider the effectiveness of merging insured depository institutions (including their respective overseas branches) in combating money-laundering activities. The Amended Statement will become effective upon its publication in the Federal Register.

For more information, contact Henry Fields at hfields@mofo.com.

Banking on China
In December, the OTS approved the application of GE Money Bank, a federal savings bank headquartered in Salt Lake City, Utah, to establish an operating subsidiary in the People's Republic of China that will initially engage in corporate lending, small business lending, and trade finance activities, and will subsequently become a full-service Chinese bank.

GE Money Bank is an indirect subsidiary of GE Capital, which in turn is a subsidiary of General Electric Company. The proposed operating subsidiary is currently a wholly owned dormant finance company subsidiary of GE Capital, organized under Chinese law and headquartered in Shanghai. In the proposed transaction, GE Money Bank will acquire all of the interests of the operating subsidiary, with the result that the operating subsidiary will become a wholly owned subsidiary of GE Money Bank. The operating subsidiary will change its name to "GE Capital Bank China."

This approval is significant as a precedent for authorizing a U.S. federal savings bank to establish and operate a subsidiary bank outside the United States. Federal banking laws long ago established the authority of national banks and other U.S. commercial banks to enter foreign banking markets. However, the federal Home Owners' Loan Act (HOLA), which governs federal savings banks, contains no explicit authority for federal savings banks to own foreign banks, consistent with the historical view of thrifts as domestic institutions created principally to facilitate home ownership in the United States.

More specifically, this approval opens the door for U.S. thrifts to participate in the unprecedented wave of U.S. and other foreign banks entering the Chinese banking market over the past several years in a variety of ways—including direct investments in existing Chinese banks, opening branches or representative offices, establishing wholly-owned Chinese bank subsidiaries, and acquiring local Chinese banks. These types of transactions, once difficult or impossible, have become increasingly feasible as China has gradually relaxed regulatory barriers to entry since its accession to the WTO.

For more information, contact Ken Kohler at kkohler@mofo.com.

Arbitration Report

Classwide Arbitration
Most companies reach for the defibrillator when they think about classwide arbitration. So, if a class action waiver that is part of a company's arbitration clause is found unconscionable, what happens? Does the case go back to court, or does the arbitrator preside over a classwide arbitration? Many businesses like to have a James Bond ejector button—a "no-savings" provision saying that if any part of the agreement is found unenforceable, the whole agreement to arbitrate gets jettisoned.

An arbitrator with the American Arbitration Association doesn't think so. He found a class action waiver in Verizon's arbitration agreement unconscionable. He then stomped through Verizon's tulip bed by finding the no-savings clause unconscionable and certifying a nationwide (except California) class against Verizon on a challenge to the company's $175 early termination fee. *See Brown v. Cellco Partnership, d/b/a Verizon*(pdf), Class Arbitration Award (Jan. 10, 2008).

Brown is a troublesome ruling. Under the Federal Arbitration Act, a court (or arbitrator) can enforce only what the parties have agreed to, and no more. Yet, in *Brown*, the one thing Verizon *didn't* agree to was classwide arbitration.

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

Waivers Wavering
Getting consumer arbitration clauses enforced is a little bit like playing miniature golf. You make it past the windmill and the bouncing spiders, only to get whacked into the moat when the drawbridge closes. These days, the drawbridge is the "class action waiver," and it is getting harder to negotiate. Two Circuits and a number of state courts already refuse to enforce class action waivers. That list grows.

On the one hand, a fractured North Carolina Supreme Court found a class action waiver in a consumer loan agreement unconscionable in *Tillman v. Commercial Credit Loans, Inc.*, 655 S.E.2d 362 (N.C. 2008). Of concern was the fact that the plaintiffs had been rushed through the loan process and that the arbitration clause was one-sided, prohibited class actions, and exposed the claimants to prohibitively high costs. According to the dissent, this was the first time in state history that a contract had been found unconscionable.

California, feeling no such qualms, saw one of its appellate courts refuse to enforce a similar provision, finding unconscionable a provision in an arbitration agreement requiring the arbitrator to decide whether an agreement is unconscionable. *Murphy v. Check 'n Go of Cal., Inc.*, 156 Cal. App. 4th 138 (2007). Worse, despite a severance provision, the court struck down the arbitration agreement in its entirety because it also contained an unconscionable class action waiver.

On the other hand, the Third Circuit has shown support for class action waivers in *Gay v. CreditInform*, 2007 U.S. App. LEXIS 29302 (3d Cir. Dec. 19, 2007), by affirming an order to compel arbitration on an individual basis where the arbitration agreement contained a class action waiver. Plaintiff, who brought her claims under the federal Credit Repair Organizations Act, 15 U.S.C. §§ 1679 *et seq*. (2000) (CROA), and comparable state law, argued that the class action waiver was void because CROA expressly contemplates class actions and also voids
"[a]ny waiver by any consumer of any protection provided by or any right of the consumer under [the Act]." The court rejected that argument on the ground that, though CROA contemplates class actions, it does not create a right to bring a class action. The court also rejected plaintiff's claim that the class action waiver was unconscionable.

A district court in Pennsylvania has also upheld a class action waiver in a "payday" loan agreement in *O'Shea v. Direct Fin. Solutions, LLC*, 2007 U.S. Dist. LEXIS 90079 (E.D. Pa. Dec. 5, 2007). The court held that the agreement to arbitrate was not unconscionable because, where an agreement expressly waives a plaintiff's right to proceed as a class, the court should "enforce the parties' arbitration as they wrote it." *Id.* at *11. The court further held that just because the plaintiff may only be entitled to $300 in nominal damages did not require the court to refuse to enforce the waiver.

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

Preemption Report

MoFo Wins Major Federal Preemption Case
On February 20, the U.S. Supreme Court handed the Firm a unanimous victory on behalf of three trade associations in a suit against the State of Maine over whether the Federal Aviation Administration Authorization Act of 1994 (FAAAA) preempts a Maine law that regulates the manner in which commercial carriers must deliver packages containing tobacco products.

The Supreme Court's decision was the first ruling on the scope of the FAAAA's preemption of state regulation of commercial carrier prices, routes, and services. The Court held that the FAAAA preempts any state regulation that directly or indirectly affects in a significant manner the prices, routes, or services of carriers. State regulation, such as the Maine law, which affects a carrier's delivery services interferes with the deregulation goal of Congress in enacting the FAAAA, and poses a real threat of creating a patchwork of inconsistent state regulation that would undermine the highly efficient and cost-effective transportation of goods throughout the nation.

This significant ruling applies to almost all of the nation's motor vehicle and air cargo carriers in an industry that transports more than $6 trillion of goods in interstate commerce annually. The ruling also should benefit the nation's passenger airlines, which are governed by another federal statute with identical statutory language.

For more information, contact Beth Brinkmann at bbrinkmann@mofo.com, who argued the case.

Ninth Circuit Finds No Holes in HOLA
Can a plaintiff use a state law on unfair and deceptive practices to extend a remedy provided by federal law? In *Silvas v. E*Trade Mortgage Corp.*, ___ F.3d ___, 2008 WL 239422 (9th Cir. Jan. 30, 2008) the Ninth Circuit said no, at least where the defendant is a federal savings and loan association. *Silvas* was a challenge to the mortgage lender's $400 "lock-in fee," which the lender failed to refund after the borrower exercised his right of rescission. The plaintiff waited long past the TILA's one-year statute of limitations, then sued under California's unfair competition law. The Ninth Circuit held the claim preempted because of the Home Owners Loan Act and OTS regulations, which occupy the field of disclosures.

A week earlier, a district court in Michigan relied on the same OTS regulations in granting a federal thrift's motion to dismiss a challenge to certain payoff fees brought under state usury, recording, and consumer protection statutes. *Molosky v. Washington Mutual Bank*, No. 07-CV-11247, 2008 WL 183634 (E.D. Mich. Jan. 18, 2008).

It is debatable whether the same result would apply under the National Bank Act. Other courts have held that there is nothing wrong in using a state UDAP act to stretch a federal remedy.

For further information, contact Brian Matsui at bmatsui@mofo.com, who submitted an amicus brief on behalf of the American Bankers Association and the California Bankers Association.

A Distinction With a Difference
A "live check" is a promotion that invites a credit card holder to tear off a perforated check and cash it, essentially taking a cash advance. Several years ago, California enacted a "live check" disclosure statute. In January, the Ninth Circuit concluded that it is preempted by the National Bank Act and OCC regulations. *Rose v. Chase Bank US, N.A.*, ___ F.3d ___, 2008 WL 185491 (9th Cir. Jan. 23, 2008). The court found that state law claims alleging unfair or deceptive practices were also preempted because they were based on a duty to disclose that is within the scope of the NBA and the OCC.

Taking a narrower approach, a district court in San Francisco rejected a national bank's argument that state law consumer protection claims challenging its prepayment practices were preempted by the NBA and OCC regulations. *Jefferson v. Chase Home Finance*, 06-6510, 2007 WL 4374410 (N.D. Cal. Dec. 14, 2007). The court found that plaintiff contended that Chase had failed to comply with its own prepayment procedures rather than that state law imposed additional or conflicting obligations. Because plaintiff's state law claims alleged violations of general legal duties rather than duties specific to lending activities, they were not preempted by federal law.

For more information, contact Rick Fischer at rfischer@mofo.com.

Mortgage Report

Cram Down Update
On February 28, Senate Republicans filibustered a bill that would permit bankruptcy judges to treat all mortgages secured by a borrower's primary residence (including home equity loans) as unsecured credit. S. 2636 would allow bankruptcy judges to lower mortgage interest rates and cramdown loan balances in Chapter 13 proceedings. The bill is not limited to subprime and non-traditional mortgage loans; thus, any loan secured by a borrower's principal residence would be potentially eligible for a cramdown. President Bush has vowed to veto the bill.

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

Eleventh Circuit Clarifies Section 8 of RESPA …
In January, the Eleventh Circuit narrowed its earlier *Culpepper* decision, which pretty much ended class action certifications for broker compensation challenges under Section 8 of RESPA. In *Busby v. JRHBW Realty, Inc.*, No. 06-15308, 2008 U.S. App. LEXIS 996 (11th Cir. Jan. 17, 2008), the Eleventh Circuit reversed the denial of class certification in a RESPA action challenging the propriety of a realty company's "Administrative Brokerage Commission" fee. The district court had denied class certification after concluding that individualized issues predominated concerning the reasonableness of the fee. The Eleventh Circuit reversed, holding that plaintiffs' allegation that the fee was improper under RESPA because *no* services were actually rendered by defendant in exchange for that fee was sufficient to support class certification. In particular, the court held that the "reasonableness" test used by the district court only applied when some services were rendered for the fee, not, as in this case, when no services were performed.

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

… and Then Clarifies Some More
The Eleventh Circuit affirmed the grant of summary judgment in favor of defendants Countrywide and its affiliate, Landsafe, Inc., in a RESPA action alleging "kickbacks" of credit report fees. *SeeKrupa v. Landsafe, Inc.*, No. 07-10061, 2008 U.S. App. LEXIS 1184 (11th Cir. Jan. 22, 2008). Countrywide purchased credit reports from Landsafe, and Landsafe changed its pricing structure to increase the charge for credit reports of

customers who locked their loans, but reduced to zero the fee paid by Countrywide for reports on customers who did not lock a loan. The court held that the changed fee structure did not constitute an illegal kickback under RESPA because Countrywide did not retain any of those fees, and because Landsafe did not get any additional business from Countrywide as a result of the pricing change.

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Want Rescission? Take Discovery

Lenders, take discovery of the borrower's ability to repay the loan before asking the court to grant summary judgment on a TILA rescission claim or to reorder the sequence of rescission. In *Williams v. Saxon Mortgage Co.*, No. 06-0799-WS-B, 2008 U.S. Dist. LEXIS 131 (S.D. Ala. Jan. 2, 2008), the lender argued that summary judgment should be granted in its favor in a TILA case because the borrowers could not tender the proceeds of the loan. The problem? They had no evidence. The court denied summary judgment: "In a case about rescission, surely it would behoove the creditor to inquire during the discovery process as to the debtor's ability to comply with its obligations under § 1635(b)." That's good advice.

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Time, and Money

A mortgage lender's use of an "equal-months" interest calculation in the year a mortgage loan is paid off does not violate California's unfair competition law, said a California appellate court, even if a 30.4-day month computation results, for some borrowers, in an interest charge for fictitious days in the year of payoff. Because this is what the FRB's Reg. Z requires (*see* 12 C.F.R. § 226, App. J(b)(5)(ii), (iv)), the practice cannot be "unlawful, unfair, or fraudulent." *Puentes v. Wells Fargo Home Mortgage*, ___ Cal. App. 4th ___ (Cal. Ct. App. Feb. 28, 2008).

Say It Ain't So, Sallie

In December, Sallie Mae was hit with a class action complaint. In *Rodriguez v. Sallie Mae(SLM) Corporation*, D. Conn. Case No. 3070V1866 (WWE), plaintiffs allege that Sallie Mae systematically discriminates against minorities in the origination and underwriting of private student loans in violation of, among other laws, the Equal Credit Opportunity Act and the Truth in Lending Act. In particular, plaintiffs claim that Sallie Mae unlawfully steered minority buyers to high-cost student loans, and that its minority borrowers were charged disproportionately high interest rates as compared with Caucasian borrowers.

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