

July 7, 2010 | Posted By

## [OHIO FEDERAL DISTRICT COURT RULES THAT HUD'S SHAM JOINT VENTURE GUIDELINES ARE UNCONSTITUTIONAL](#)

In a decision that was handed down on June 30, 2010, a United States District Court for the Northern District of Ohio has ruled that HUD's sham joint venture guidelines, as contained in HUD's RESPA Statement of Policy 1996-2 (the "Policy Statement"), are unconstitutionally vague, and has granted the defendants summary judgment against claims by the plaintiffs that certain affiliated title agencies violated RESPA. *Carter v. Wells-Bowen Realty, Inc.*, 2010 WL 1607266.

The plaintiffs were two individuals who, in connection with obtaining mortgage loans, purchased title insurance services from Welles Bowen Title Agency ("WB Title") and Integrity Title Agency ("Integrity Title"). WB Title was formed as an affiliated business arrangement by defendants Chicago Title and Welles Bowen Realty. Integrity Title was formed as an affiliated business arrangement by defendants Chicago Title and the Danberry Co., which, like Welles Bowen Realty, is a real estate broker. Chicago Title owned 50.1% of WB Title and Integrity Title, and Welles Bowen Realty and Danberry Co. owned the other 49.9% of WB Title and Integrity Title respectively. The plaintiffs alleged that WB Title and Integrity Title performed limited services, and that they were sham companies that were formed to be conduits for kickbacks from Chicago Title to Welles Bowen Realty and Danberry Co. in exchange for referrals. Plaintiffs did not allege that they received subpar title insurance services or that they were overcharged for the services they received, although the court acknowledged (as the Sixth Circuit had held in an earlier decision in this case) that overcharges were not necessary to prove a RESPA violation.

The defendants moved for summary judgment, arguing that WB Title and Integrity Title performed real title services, and had also complied with all of the requirements for affiliated business arrangements set forth in RESPA and Regulation X, in that the joint venture companies had provided timely affiliated business arrangement disclosures, had not required that the plaintiffs use any particular title agency, and that the only thing of value that the owners of WB Title and Integrity Title had received was a return on their ownership interests in WB Title and Integrity Title. The defendants also argued that the guidelines set forth in the Policy Statement were unconstitutionally vague and therefore unenforceable. The court agreed with the defendants.

The court first pointed out that, since RESPA violations can result in criminal penalties, the claim of vagueness requires fairly strict review, even though only civil penalties were sought by the plaintiffs. The

court then analyzed the Policy Statement guidelines, including the ten factor test employed by HUD in the Policy Statement, and found that the guidelines' use of terms such as "sufficient capital," "reasonable compensation" and "performance of substantial services" required inherently subjective evaluations without any guidance as to how to determine what levels of capital were sufficient, what compensation was reasonable, and what level of service performance was substantial. The court also found that the balancing of the ten factors in the Policy Statement guidelines compounds the vagueness because there is no description in the Policy Statement as to how the factors are to be balanced.

It is likely that an appeal will be made to the Sixth Circuit on this issue. HUD will no doubt be filing a brief in support of its Policy Statement. One potential argument by HUD might be that it never intended for the joint venture guidelines to be privately or judicially enforced, and that it was simply attempting to inform the industry and the public what factors it would consider in evaluating whether particular affiliated business arrangements were sham arrangements. We will be monitoring this case closely, but in the meantime, we urge our clients with affiliated business arrangements to continue to attempt to comply with the Policy Statement to the greatest extent possible.

Authored By:

[Sherwin F. Root](#)

(213) 617-5465

[SRoot@sheppardmullin.com](mailto:SRoot@sheppardmullin.com)