CONSUMER FINANCIAL SERVICES LAW REPORT

FOCUSING ON SIGNIFICANT CASELAW AND EMERGING TRENDS

APRIL 24, 2012 | VOLUME 15 | ISSUE 19

INSIDE

FAIR DEBT

8TH CIRCUIT: FALSE STATEMENTS IN COURT FILINGS MAY VIOLATE FDCPA — BUT NOT ALWAYS

A federal appellate court, in a case of first impression, rejected a debtor's Fair Debt Collection Practices Act claims premised on pleadings filed by a debt collector in a state-court collection action. The collection lawsuit failed and the debtor filed an FDCPA action for harassment, false or misleading representations in the state court action, and unfair practices — all based upon the debt collector's summary judgment motion and supporting affidavit filed during the state-court litigation.

The 8th U.S. Circuit Court of Appeals, adopting a "case-by-case," circumstantial approach to such actions, affirmed the district court's dismissal. The appellate panel rejected the "broad ruling" of the court below that false statements not made directly to a consumer debtor are never actionable under the FDCPA — such as those made in court filings during the course of debt-collection litigation. However, the appellate panel held that, in this case, the debtor's FDCPA claims failed because evidence before the district court supported the debt collector's pleadings in the state-court action. *(Hemmingsen v. Messerli & Kramer, P.A.*, No. 11-2029, 2012 WL 878654 (8th Cir. 03/16/12).)

George Hemmingsen opened a Discover Bank credit card account in September 2002. He married a month later and added his wife Heather Hemmingsen to the account, which Discover characterized as a "joint account" in its monthly statements. The couple divorced in 2005, and in their "Marital Termination Agreement" said that both parties owed an unpaid balance on the Discover account incurred for "living expenses," but that George was responsible for the debt and would hold Ms. Hemmingsen harmless for the liability. Discover wrote off the account in April 2007 and retained Messerli & Kramer PA to recover the unpaid balance. M&K commenced a collection action

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closures, in furtherance of the statutory purpose of the integrated disclosures under TILA and RESPA, which is, in part, to aid the consumer in understanding the transaction."

Find the survey notice and request for comment at gpo.gov/fdsys/pkg/FR-2012-03-28/pdf/2012-7465.pdf. *Find the integrated disclosure form request for comment at* gpo.gov/fdsys/pkg/FR-2012-03-28/pdf/2012-7463.pdf.

GUEST COMMENTARY

THE CONSTRICTED SCOPE BUT CONTINUING APPLICATION OF STATE-LAW PREEMPTION

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Preemption allows federally regulated banks to operate without regard for conflicting state regulations. The Dodd-Frank Act constricted application of federal preemption of state laws. However, application of those changes is largely untested. This article is intended to identify the significance of the changes, while showing that preemption of state regulations for national banking institutions continues, and in many instances, will not be affected by Dodd-Frank.

Real world application of this can be seen in consumer lawsuits arising from commercial and residential loans, and how federal law preempts state statutes. In particular, federally regulated banks remain entitled to preemption of state regulations affecting terms of interest and related fees, and their non-bank agents (such as loan servicers) are likely entitled to the same protection.

FINANCIAL INSTITUTIONS ENTITLED TO PREEMPTION

The applicable federal statute depends on the type of bank that originated the loan at issue:

- National associations are regulated by the National Bank Act, 12 U.S.C.A. § 1 *et seq.*
- Federal savings associations are regulated by the Home Owners Loan Act, 12 U.S.C.A. § 1461 *et seq.*
- State-chartered, federally insured banks are regulated by the Depository Institutions Deregulation and Monetary Control Act, 12 U.S.C.A. § 1831d.

Lending banks and their agents — loan servicers and collection companies — may be entitled to preemption if the debt was originated by a bank governed by the NBA, HOLA, or DIDA. There are three types of preemption that may apply under differing circumstances:

1) *Express preemption* or *complete preemption* is limited to statutes in which Congress has explicitly stated its intent to displace state law.
2) *Field preemption* occurs when federal regulation is so pervasive in the area or subject matter that Congress has implied its intent to occupy the entire field of regulation.
3) *Conflict preemption* arises when it is impossible to comply with both the federal and the state statute, or when the state statute creates a significant obstacle (also known as *obstacle preemption*) to accomplishing the purpose of the federal statute.

DODD-FRANK LIMITS HOLA PREEMPTION

Overall, state statutes are most likely to be preempted under express preemption, likely to be preempted under field preemption, and unlikely to be preempted under conflict preemption. Generally, courts have applied field preemption under HOLA and conflict preemption under the NBA. The trend has been that more state consumer claims have been preempted under HOLA than the NBA, as seen from federal courts in California and West Virginia, two jurisdictions where this defense has been heavily litigated.

In *Robinson v. Bank of Am., N.A.*, No. CV 11-03939-GHK (JEM), 2011 WL 5870541 (C.D. Cal. 10/19/11), the U.S. District Court, Central District of California explained: "The correct legal standard for whether conflict preemption bars the application of those or any laws [is] 'States are permitted to regulate the activities of national banks where doing so does not prevent or significantly interfere with the national bank's . . . exercise of its powers. But when State prescriptions significantly impair the exercise of authority enumerated or incidental under the NBA, the State's regulations must give way," quoting *Watters v. Wachovia Bank, N.A.*, 550 U.S. 1 (2007).

In *O'Neal v. Capital One Auto Fin., Inc.*, No. 3:10-CV-40, 2011 WL 4549148 (N.D.W.Va. 09/29/11), the U.S. District Court, Northern District of West Virginia said: "[T]he Supreme Court made clear that the NBA does not have field-preemptive force such that states may not regulate national banks at all. To the contrary, na-

tional banks 'are subject to state laws of general application in their daily business to the extent such laws do not conflict with the letter or the general purposes of the NBA,'" also quoting *Watters*. The U.S. District Court, Southern District of West Virginia, in *Smith v. BAC Home Loans Servicing*, 769 F. Supp. 2d 1033 (S.D.W.Va. 2011), concluded that "Congress and the [Office of the Comptroller of the Currency] never intended to occupy the entire field of national banking regulation."

The most significant change to federal preemption by Dodd-Frank is that courts applying the NBA and HOLA will use conflict preemption for both (but not field preemption for HOLA). Preemption now only applies "in accordance with the legal standard for preemption" in the Supreme Court's decision in *Barnett Bank of Marion County, N.A. v. Nelson*, 116 S.Ct. 1103 (1996) if the state consumer financial law "prevents or significantly interferes with the exercise by the national bank of its powers" (Dodd-Frank Act § 1044(b); § 1046 (codified at 12 U.S.C.A. § 1465)). This restricts HOLA to the more limited preemption provided by NBA. Further, Dodd-Frank eliminates preemption of state law for federally regulated banks under NBA and HOLA for non-bank subsidiaries, agents. (Dodd-Frank §§ 1044 through 1046.)

These changes are significant but do not change the validity of preemption defenses in ongoing litigation because the Dodd-Frank preemption amendments are not retroactive. Further, Dodd-Frank does not affect the express preemption provisions within HOLA, DIDA, and the NBA — specifically, the terms of "interest" set by banking institutions.

PREEMPTION AMENDMENTS NOT RETROACTIVE

The majority of courts have found that the preemption amendments in Dodd-Frank are not retroactive, but apply from either the July 21, 2010 date of Dodd-Frank's enactment, or its July 21, 2011 effective date.

"Date of enactment" cases include:

- *Settle v. World Sav. Bank*, No. 11-800 (C.D. Cal. 01/11/12), holding that "claims involving contracts formed before July 21, 2010 are subject to the preemption regime in place before Dodd-Frank [because] Section 1043 of the statute specifically states that contracts formed prior to the passage of Dodd-Frank will be governed by the rules and regulations in place prior to its enactment."
- *Copeland-Turner v. Wells Fargo Bank*, No. CV-11-37-HZ, 2011 WL 996706 (D. Or. 07/06/11), stating: "The Act was effective July 21, 2010. Under Section 1043, any contracts entered into on or before that date are not subject to the new legislation."

"Effective date" cases include:

- *Molosky v. Wash. Mut., Inc.*, 664 F.3d 109 (6th Cir. 2011), holding that Dodd-Frank preemption amendments became effective July 21, 2011 and have no retroactive effect. The 6th U.S. Circuit Court of Appeals reasoned that there "is no explicit statement from Congress that they are meant to be retroactive, suggesting no retroactivity" and "Dodd-Frank Act itself declares that its contents should not be construed as retroactive."
- *Davis v. World Sav. Bank, FSB*, 806 F.Supp.2d 159 (D.D.C. 2011), which opined that "Congressional enactments and administrative rules will not be construed to have retroactive effect unless their language requires this result," quoting *Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204 (1988).
- *Williams v. Wells Fargo Bank N.A.*, No. 11-21233-CIV, 2011 WL 4901346 (S.D. Fla. 10/14/11), holding that claims arising before July 21, 2011 are analyzed by preemption rules in effect prior to Dodd-Frank, citing § 1048 as making the preemption amendment effective on the "designated transfer date."

One court, the U.S. District Court, Southern District of West Virginia, has held that the preemption amendments in Dodd-Frank apply retroactively. In *Cline v. Bank of Am., N.A.*, No. 2:10-1295, 2011 WL 4857934 (S.D.W.Va. 10/13/11), the court wrote: "The recent amendments are better understood as clarifications of the law as opposed to substantive changes thereof. As such, their application here does not work an impermissible retroactive effect." That ruling appears to be an anomaly and was limited to NBA preemption of collection claims unrelated to "interest". The weight of the authority is that the Dodd-Frank preemption amendments are not retroactive.

EXPRESS PREEMPTION OF SOME STATE LAWS

The U.S. Supreme Court has indicated that certain provisions of the NBA, HOLA, and DIDA are entitled to express preemption—specifically, provisions governing the "interest" that federally regulated banks may charge. In *Ben. Nat'l Bank v. Anderson*, 539 U.S. 1 (2003), the Court held: "In actions against national banks for usury, these provisions supersede both the substantive and the remedial provisions of state usury laws and create a federal remedy for overcharges that is exclusive, even when a state complainant, as here, relies entirely on state law. Because [NBA] §§ 85 and 86 provide the exclusive cause of action for such claims, there is, in short, no such thing as a state-law claim of usury against a national bank."

The NBA, HOLA, and DIDA, and their implementing regulations have substantively identical provisions governing permissible interest rates and what fees constitute interest. *See* NBA provisions 12 U.S.C.A. § 85 & 12 C.F.R. § 7.4001(a); HOLA provisions 12 U.S.C. § 1463(g) & 12 C.F.R. § 560.110(a); DIDA provision 12 U.S.C.A. § 1831d. These federal statutes include a broad definition of "interest" as "any payment compensating a creditor or prospective creditor for an extension of credit, making available of a line of credit, or any default or breach by a borrower of a condition upon which credit was extended" that expressly includes, among other things, late fees, fees for "not sufficient funds" (NSF), "overlimit fees," annual fees," cash advance fees," and "membership fees." 12 C.F.R. §§ 7.4001(a) & 560.110(a).

NO CHANGE IN PREEMPTION OF STATE "INTEREST" STATUTES

Dodd-Frank did not amend the definition of "interest" or change the interest rates permitted in the NBA, HOLA, or DIDA. Therefore, state statutes that purport to govern "interest" are expressly preempted from applying to banks regulated by the NBA, HOLA, or DIDA even after Dodd-Frank. Certainly if those state statutes are more restrictive of interest, even under the *Barnett Bank* "significant interference" test for conflict preemption, the result should be the same: no application to the federally regulated bank.

This is significant to banks and their subsidiaries or agents. For example, consider charges for late fees. The U.S. Supreme Court has expressly stated that late fees constitute "interest" under the NBA. In *Phipps v. FDIC*, 417 F.3d 1006 (8th Cir. 2005), the 8th U.S. Circuit Court of Appeals said that "the Supreme Court has held various fees, such as late fees, are not excluded from the NBA's definition of interest simply because the fees do not vary depending on the amount owed or the length of the delay, citing *Smiley v. Citibank, N.A.*, 517 U.S. 735 (1996), which held that late fees constitute "interest" under the NBA. The 4th U.S. Circuit Court of Appeals also noted the Supreme Court's conclusion that late fees are "interest." In *Discover Bank v. Vaden*, 489 F.3d 594 (4th Cir. 2007), *rev'd on other grounds*, the appellate panel wrote:

> Given the express preemption language of [DIDA], the statute's legislative history affirming Congress' intent to provide competitive equality between national and state-chartered banks, the virtual identity of the preemption language in the NBA and that of [DIDA], and the Supreme Court's finding of complete preemption under the NBA, we are hard-pressed to conclude other than that Congress intended complete preemption of state-court usury claims under [DIDA].

Although there is little case law on the issue of preemption of state claims arising from late fees, at least one court has addressed the issue under HOLA. The U.S. District Court, Northern District of West Virginia in *Owens v. Cent. Mortg. Co.*, No. 08-114 (N.D.W.Va. 12/22/08) held that claims under the state's consumer protection statute alleging improper late fees (in excess of a $15 maximum) are preempted under HOLA.

In addition, the U.S. District Court, Southern District of West Virginia in *Bishop v. Ocwen Loan Servg, LLC*, No. 3:10-0468, 2010 WL 4115463 (S.D.W.Va. 10/19/10), cited *Owens* with approval but noted that it was factually distinguishable because the late fees issue arose from breach of contract — charging more than permitted by the note — which was exempt from preemption). Also, in *Haehl v. Wash. Mut. Bank, F.A.*, 277 F. Supp. 2d 933 (S.D. Ind. 2003), the U.S. District Court, Southern District of Indiana held that "Section 560.2 expressly preempts state laws purporting to regulate loan-related fees and the processing and servicing of mortgages."

The courts in each of these decisions were applying the pre-Dodd-Frank preemption analysis, but Dodd-Frank did not amend "interest," which is a contract term endowed with special status under the preemption framework. Rightly so, interest is the *raison d'etre* of lending. Dodd-Frank does not and should not be interpreted to require federally regulated banks to now comply with each state's different regulation of "interest" and related fees.

NO EXPRESS PREEMPTION FOR AGENTS, SUBSIDIARIES

Dodd-Frank "clarified" application of preemption to agents and subsidiaries of federally regulated banks by stating it applies "to the same extent that the State consumer financial law applies to any person, corporation, or other entity subject to such State law." Dodd-Frank Act § 1044(a). This amendment is untested, but the language of the statute and existing case law reveals that it is not a complete elimination of preemption defenses for non-bank subsidiaries and agents of federally regulated banks. Notably, the statute does not expressly deny preemption for subsidiaries and agents, as it could have. By using the words "to the same extent," Congress left open the continued application of federal preemption pursuant to agency and contract principles.

For example, if the interest rate or late fee amount set by a federally regulated bank is lawful under the NBA, HOLA, or DIDA, then it cannot be usurious under state

law. That same interest rate or late fee amount does not become usurious merely because it is now being collected by a non-bank agent. That would undermine the entire doctrine of federal preemption and prevent federally regulated banks from entering into contracts with non-bank entities (such as for the sale, securitization, or servicing of their loans) for fear that lawfully originated loans could become usurious in the hands of another.

Therefore, if the non-bank agent is merely administering the interest term set by the federally regulated bank, then the agent should also be entitled to preemption. As the *Owens* court said: "Claims against defendant Central are preempted by 12 C.F.R. § 560.2 because Central is an agent of a national bank enforcing the terms of a federally valid and lawful mortgage." And the 2d U.S. Circuit Court of Appeals in *Pac. Capital Bank, N.A. v. Connecticut*, 542 F.3d 341 (2d Cir. 2008) concluded: "If a state statute subjects non-bank entities to punishment for acting as agents for national banks with respect to a particular NBA-authorized activity and thereby significantly interferes with national banks' ability to carry on that activity, the state statute does not escape preemption on the theory that, on its face, it regulates only non-bank entities."

However, it is unlikely that any "interest" fees not set by a federally regulated bank in the loan contract may be charged later by a non-bank agent without regard for applicable state law. The relevant inquiry is what interest terms were set by the federally regulated bank during origination and whether the agent is acting in accordance with those terms. If so, the agent should be entitled to the same preemption as the federally regulated bank even after Dodd-Frank.

In any event, federal preemption cases will involve heavily fact-specific defenses requiring an individualized inquiry. Lenders, servicers, and collectors should expect preemption will continue to be an important and heavily litigated issue.

FORCE-PLACED INSURANCE

BANK SNAGGED ON STATE-LAW CLAIMS BUT AVOIDS RESPA LIABILITY

A bank that force-placed insurance on homeowners when their own hazard insurance lapsed were found not liable under the Real Estate Settlement Procedures Act when a federal judge found that FPI, occurring years after a loan's closing, is not a "settlement service" under RESPA. However, several other state-law, class action causes of action brought by the homeowners survived. (*McNeary-Calloway, et al. v. JPMorgan Chase Bank, N.A., et al.*, No. C-11-03058, 2012 WL 1029502 (N.D. Cal. 03/26/12).) (*See also* CFSLR, *April 10, p. 6, "Lender-placed insurance practices under attack from multiple directions," by Frank A. Hirsch Jr. and Ryan P. Ethridge of Alston + Bird.*)

Patricia McNeary-Calloway, living in Oakland, Calif., refinanced her Chase Bank home mortgage and obtained a hazard insurance policy. After McNeary-Calloway's husband died, the policy lapsed and Chase Home Finance LLC purchased a one-year FPI policy with American Security Insurance Co. on her behalf. The ASIC policy carried a much higher annual premium; was backdated to when the prior policy lapsed; and provided less coverage. McNeary-Calloway later received a letter from Chase Home Finance, stating that, effective Aug. 26, 2010, it had renewed the FPI policy for another year at the same rate.

McNeary-Calloway obtained her own insurance policy from another insurer with a much lower annual premium and an effective date of Sept. 1, 2010. After receiving notice of this policy, Chase Home Finance sent her a letter stating that it canceled the FPI policy, but charged her escrow account for retroactive coverage for the period extending from Aug. 26, 2010 to Sept. 1, 2010. Several other borrowers — Colin and Terrie MacKinnon of San Diego; Andrea North of Yorba Linda, Calif.; and Sheila M. Mayko of Riverside, N.J. — all had similar experiences in which Chase Home Finance bought FPI policies from ASIC on their behalf, automatically renewed and backdated the policies, and then retroactively charged them for the time period during which their policies were lapsed.

The four plaintiffs brought putative class-action claims against JPMorgan Chase NA and Chase Bank USA NA, including alleged violations of RESPA; breach of the implied covenant of good faith and fair dealing; breach of contract; UCL claims under California's Bus. & Prof. Code; violations of New Jersey's Consumer Fraud Act, and unjust enrichment. The defendants moved to dismiss.

Notably, just before the four named plaintiffs' filing, a settlement was reached in another class action involving lapsed LPI policies and ASIC (*Wahl v. Am. Sec. Ins. Co.*, C08-00555-RS (N.D. Cal. 06/02/11). The final settlement in *Wahl* included a release discharging ASIC "from any claims or liabilities arising from or related to the released claims." Among the named plaintiffs in the case at bar, North was the only *Wahl* class member who opted-out of the settlement.

The district court granted Chase's motion to dismiss in part, based in part on the limitations imposed by the *Wahl* settlement. The court dismissed the borrowers'

