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Truth in Lending Act: The viability of class actions for rescission

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Mortgage lenders have come under increased scrutiny in recent months due to the crisis in the subprime market. In response to the increased number of foreclosures, homeowners are invoking remedies under the Truth in Lending Act ("TILA") and other consumer protection statutes. In some instances, homeowners have commenced class actions against lenders seeking to rescind their transactions under TILA. This article addresses the viability of class actions under TILA and discusses the conflicting views among certain federal circuits.

The Right to Rescind under TILA

TILA was enacted in 1968 "to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing card practices."[1] TILA and the implementing Federal Reserve Board Regulation Z regulate the content and presentation of loan agreements[2] and provide borrowers with legal remedies when their lenders have failed to comply with the statutory requirements.

Among other consumer protection provisions, TILA allows a debtor to rescind a consumer credit transaction which is secured by an interest in the debtor's principal dwelling.[3] This right of rescission must be exercised by the consumer by midnight of the third business day following the consummation of the transaction or the delivery of the information and rescission forms together with material disclosures, whichever occurs later.[4] TILA places an affirmative duty on the creditor to provide the debtor with a clear and conspicuous disclosure of this right to rescind before the transaction is completed.[5]

A proper disclosure must contain the following information: (1) the retention or acquisition of a security interest in the consumer's principal dwelling; (2) the consumer's right to rescind; (3) how to exercise the right to rescind, with an attached form that the consumer can use for that purpose which designates the address of the creditor's place of business; (4) the effects of rescission; and (5) a clear and easily understandable statement disclosing the date at which the debtor's right to rescind expires.[6]

An effective and sufficient disclosure can protect the creditor's financial interest in the transaction.[7] If the creditor does not give the debtor proper notice of her right to rescind, the rescission period extends from three days to three years, providing the debtor with an escape hatch from her commitment.[8] In particular, a borrower facing foreclosure within three years of the initial transaction may be able to avoid the proceeding by claiming that the creditor provided her with a defective notice of rescission.

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The mechanics of the rescission process under section 1635 are significant to analyzing the appropriateness of class actions in this context. First, the obligor must give notice to the creditor of her intent to rescind the transaction.[9] Within twenty days of receipt of such notice, the creditor must return to the debtor any money paid and must terminate the security interest created under the transaction.[10] Once the creditor has adequately performed these actions, the debtor must tender the underlying property to the creditor. However, if the creditor fails to comply or wrongfully refuses to rescind, the homeowner/debtor can ask a court to enforce her statutory right to rescission and can also sue for additional damages and attorneys fees.[11] In this sense, courts are to be used as a last resort, determining the rights of the creditor and debtor only when the parties cannot agree between themselves.

Class Actions under TILA

Under Federal Rule of Civil Procedure 23, class actions are permissible only if: (1) the class is so numerous that joinder of all members is impracticable; (2) there are questions of law or fact common to the class; (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class; and (4) the representative parties will fairly and adequately protect the interest of the class.[12] Further, a class action may be brought if, in addition to the preceding requirements, "the court finds that the questions of law or fact common to class members predominate over any questions affecting only individual members" and that a class action is superior to other remedies for "fairly and effectively adjudicating the controversy."[13]

Class actions for damages are expressly permitted under TILA,[14] but the statute is silent as to the appropriateness of class actions in claims for rescission.[15] Public policy concerns permeate the debate of whether such actions are permissible under TILA. Opponents point to the 1974 amendments to TILA, wherein Congress placed a statutory cap on damages allowed in class actions for violations under the statute.[16] This limit on creditor liability was enacted to protect lenders from bankruptcy as a result of TILA litigation. By allowing class-wide rescissions, opponents argue, lenders could potentially face a loss of millions of dollars, well above the statutory cap, as numerous mortgages are simultaneously terminated. Supporters of class actions argue that the underlying purpose of TILA is to protect consumers and, therefore, class actions should be readily accessible for rescission claims where the lender has wronged the public, as a whole, for its improper lending practices.

Recently, class plaintiffs have sought declarations from courts to determine their rights to rescind. This distinction between an action for a mere declaration of a borrower's rescission rights and an action for an exercise of such rights has been at the center of the controversy. District courts located in the Seventh Circuit have repeatedly found that class actions for rescission are allowable so long as they properly meet the requirements of Rule 23. On the other hand, the First Circuit in *McKenna v. First Horizon Home Loan Corp.*,[17] departed from the rulings of its lower courts[18] and held that class actions were against the congressional intent of TILA and were therefore not allowed.

The First Circuit

In *McKenna*, First Horizon, the lender, allegedly sent out defective rescission notices to a class of Massachusetts homeowners. Instead of using the Model Form notices recommended TILA, the lender's notice read, in part: "For new transactions involving us, if you cancel the new transaction, your cancellation will apply only to the increase in the amount of credit. It will not affect the amount that you presently owe or the mortgage lien, or security interest we already have on your home."[19] Plaintiffs claimed that such language was ambiguous, thereby making it difficult to determine to what transactions the right to cancel would apply.

Plaintiffs sought a declaration that any "class member who so desire[d] [could] seek to rescind their transaction"[20] because the notice allegedly violated the TILA requirements under section 1635. The complaint alleged that a class action was superior to any other form of adjudication because it was not economically feasible for all the class members to bring individual claims.[21]

Agreeing with the Fifth Circuit in *James v. Home Constr. Co. of Mobile*,[22] the First Circuit reversed the decision that certified the class stating that such relief is unavailable due to the "purely personal" nature of the rescission remedy.[23] In so holding, the *McKenna* court relied on its analysis of the congressional intent behind the rescission provision. In particular, the court noted that class actions are specifically available in suits for damages due to violations of TILA, but are not expressly mentioned in the rescission provisions. This divergence in treatment strongly indicated to the court that "Congress did not intend to include a class-action mechanism within the compass of section 1635."[24]

While the underlying proposition of TILA was to protect consumers, the court also found that Congress intended to protect, to some extent, the creditors themselves: "[Congress] had not intended that lenders would be made to face overwhelming liability for relatively minor violations."[25] Allowing class-wide rescissions, the court reasoned, could result in higher volatility in the housing finance market due to the numerous mortgage loans that could be terminated in one action.[26]

The court disposed of plaintiff's contention that the exclusion of class actions from the rescission provision may have been the result of congressional intent to have such class actions available without restraint. Under the facts of the case, the lender had liability exposure of almost $200 million dollars, which is "considerably in excess" of the damages cap that Congress had "painstakingly established for damages class actions."[27] The court determined that allowing a lender to be exposed to such an extraordinary amount of damages in rescission claims "strains credulity."[28] Notably, the court found that its examination and findings of class actions under TILA applied to both declaratory actions and claims for actual rescission.[29]

District Courts Within the Seventh Circuit

In *Andrews v. Chevy Chase Bank*,[30] the Eastern District of Wisconsin found that class certification was appropriate for rescission claims under TILA. In writing his opinion, Judge Adelman found no significance in the divergence of treatment within TILA with respect to damages and rescission, stating that "it is just as likely that Congress did not intend to limit rescission claims in any way."[31] The court rejected any analysis of congressional intent stating that the language of TILA is plain and "does not bar courts from certifying classes whose members have a right to rescind."[32] Against this lack of direct prohibition, it stated that, "courts should only consider whether the requirements of Rule 23 are met."[33]

In April 2007, another district court within the Seventh Circuit found that class certification for rescission was appropriate. The court in *In re Ameriquest Mortgage Co.*,[34] disagreed with the *McKenna* holding and held that neither Rule 23 nor TILA prohibits such actions. The court was clear in distinguishing between actual rescission and the declaratory relief sought: "While we recognize that actual rescission is a personal remedy, we find nothing in TILA precluding declaratory relief authorizing class members to individually request rescission where they are legally entitled to do so."[35] In so finding, the court stated that class certifications of this nature would come at "no direct cost to defendants or the integrity of the TILA damages cap."[36]

As of this writing, the Seventh Circuit Court of Appeals has not addressed whether a borrower may bring a class action for rescission under TILA. If that circuit follows the rationale of some of the district courts there,[37] it will lead to a split between the First, Fifth, and Seventh Circuits – resulting in uncertainty for lenders and borrowers as to what their rights and remedies are under TILA.

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1. 15 U.S.C. § 1601(a) (2006).
2. *See* 12 C.F.R. § 226 (2003).
3. 15 U.S.C. § 1635 (a) (2006). *See also* 12 C.F.R. § 226.15(a): "in a credit plan in which a security interest is or will be retained or acquired in a consumer's principal dwelling, each consumer whose ownership interest is or will be subject to the security interest shall have the right to rescind."
4. 15 U.S.C. § 1635 (a) (2006).
5. *Id.*
6. 12 C.F.R. § 226.15 (c) (2003).
7. *See* 15 U.S.C. §1635 (h) (2006) (stating that if the creditor uses the form of notice published and adopted by the Board, the obligor will have no rescission rights arising from the form of notice given).
8. *See* 12 C.F.R. § 226.15 (a)(3) (2003).
9. 15 U.S.C. §1635 (a) (2006).
10. 15 U.S.C. §1635 (b) (2006).
11. 15 U.S.C. §1635 (g) (2006).
12. F.R.C.P. §23 (a).
13. F.R.C.P. §23 (b)(3).
14. 15 U.S.C. §1640 (2006).
15. 15 U.S.C. §1635 (2006).
16. 15 U.S.C. §1640 (a)(2)(B) (2006) states: "in the case of a class action, such amount as the court may allow, except that as to each member of the class no minimum recovery shall be applicable, and the total recovery under this subparagraph in any class action or series of class actions arising out of the same failure to comply by the same creditor shall not be more than the lesser of $500,000 or 1 per centum of the net worth of the creditor."
17. 475 F.3d 418 (1st Cir. 2007).
18. *See Rodrigues v. Members Mortg. Co.*, 226 F.R.D. 147 (D. Mass. 2005) (certifying a class for declaration of right to rescission because requirements of FRCP 23 had been met); *See also McIntosh v. Irwin Union Bank & Trust, Co.*, 215 F.R.D. 26 (D. Mass. 2003) (holding that class actions were available for declaration of rescission rights by utilizing F.R.C.P. 23 analysis).
19. Complaint at 12, *McKenna v. First Horizon Home Loan Corp.*, 475 F.3d 418 (1st Cir. 2007) (No. 06-0810).
20. *McKenna*, 475 F.3d at 421.
21. Complaint at 28, *McKenna v. First Horizon Home Loan Corp.*, 475 F.3d 418 (1st Cir. 2007) (No. 06-0810).
22. 621 F.2d 727 (5th Cir. 1980) (holding that the language of 1635(b) gives the creditor [20] days to complete the steps of rescission with each individual obligor before the matter can be brought to court and as a result, such rescission is purely personal between the creditor and each individual debtor).
23. *McKenna* at 423, citing James, 621 F.2d 731.
24. *See McKenna* at 423 (also stating that "the inclusion of a specific provision in one part of a statute and the exclusion of the same sort of provision in another part of the same statute should be treated as deliberate").
25. *Id.* at 425.
26. *See Id.* at 424 (quoting from the Congressional Record that such "wholesale rescission" would be a "real danger" to the mortgage business and lead to "devastating liability" to such lenders).
27. *McKenna* at 424.
28. *Id.*
29. *See McKenna* at 427 (stating that declaratory judgments would "work against judicial economy and disserve efficiency concerns").
30. 474 F.Supp.2d 1006 (E.D. Wis. 2007).
31. *Id.* at 1008.
32. *See Id.* at 1009 (stating that a court should inquire about legislative intent only where the statute's language is unclear and ambiguous. Where the language of the statute is plain on its face, and does not lead to an absurd result, the language itself is the sole evidence of the ultimate congressional intent).
33. *Id.* The court also stated: "The 'right' to proceed as a class action, insofar as the TILA is concerned, is a procedural one that arises from the Federal Rules of Civil Procedure." Citing *Johnson v. West Suburban Bank*, 225 F.3d 366, 371 (3d Cir. 2000) (enforcing an arbitration clause where a class of plaintiffs alleged that lender failed to disclose material information about interest rates).
34. *In re Ameriquest Mortgage Co. Mortgage Lending Practices Litigation*, 2007 WL 1202544 (N.D. Ill. 2007).
35. *Id.* at 3.
36. *Id.*
37. *See also Latham v. Residential Loan Centers of America* 2004 WL 1093315 (N.D. Ill. 2004) (stating in dicta that certifications of class actions should only be analyzed under FRCP 23).