

CURRENT AND PENDING LAWSUITS AND CLASS ACTIONS

(or)

“Lurid Lender Litigation Laments for 2009”

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Introduction: Throughout 2007 & 2008, my lecture attendees around the nation learned about hidden “tricks, traps and tripwires” tucked into state and federal statutes and regulations. Many learned of predatory litigators ready to entangle the unwary secured and unsecured lender in nuisance litigation, with potentially corrosive risks. This year, the following materials will feature 3 of the “darlings *du jour*” of consumers’ rights lawsuits for 2009.

The goal of the materials that follow is to discuss which selected opportunities in statutes and regulations have proven appealing this year to disgruntled and disillusioned consumers, commercial borrowers and even some credit unions! (Regrettably, the juiciest cases never get reported. They get settled and their terms are usually made confidential).

I. Forestalling Foreclosure with the “Qualified Written Request” (12 USC §2605(e) & (f); Reg. X, §3500.21(f)(1)).

A. Quickly gaining a reputation as a “foreclosure freezer”, the QWR has become the expedient response to any mortgage lender’s acceleration notice in 2009. Expect them to become more widespread until mortgage cramdown passes the Senate.

1. Many states have (or have adopted) a statutorily required “notice of impending foreclosure” letter, similar to North Carolina’s own GS §53-243.11.

a. Center for Responsible Lending, based in Durham, NC & D.C., advocates adoption of similar statutes and can furnish suggested text to state legislators.

b. The model of NC’s own “45 day letter” attached is for illustrative purposes only. (Some CUs in NC choose to mail their own as a cost-saving measure. *Caveat emptor.*)

2. Lenders and their servicers who fail to dispatch such letters (when required by the statute of the state *where the land and members are located, not the CU's state*) expose themselves to an array of statutory damages or at least a "do-over" foreclosure sale.

3. Designed to inform defaulted mortgagees of available resources, they frequently push the panic button and send members scrambling to bankruptcy lawyers & the Internet. The latter is free. Lawyers aren't.

B. In response to a CU's delinquency notice or warning of foreclosure, members will respond with a QWR by certified mail. The goal: buy time and then occasional jackpots.

1. Once a lawyer's private weapon-of-choice, QWR's may still arrive on law-firm letterhead. See attached example downloaded from a bankruptcy attorney listserv. (Note the absence of response deadline details).

2. Any debtor with access to the Internet (*i.e.*, anyone who can find a public library) can download similar examples after a 30-second Google search. Some are even available as word processing documents.

a. Fill in the blanks, print it out, find a post office and dispatch it by certified mail.

b. Sometimes addressed to payment lockboxes instead of collections desks, its arrival triggers two sequential deadlines:

(i) 20 days to acknowledge receipt (hence the certified mail, to know when to start the clock); then

(ii) 60 days from receipt to respond in substance to the request for information as detailed in the letter.

3. QWR's routinely ask for a copy of the original Note, since urban legend has it no foreclosing creditor can produce it.

a. CUs have discovered (to their horror) notes or mortgages lacking spouses' signatures, omitted legal descriptions, mis-recorded loan documents, incomplete or misplaced HUD-1's, incorrectly adjusted ARMs, & overdrawn HELOCs, misapplied payments,

b. Reg. Z violations are often rampant in CU loan documents.

4. 2nd most popular: demand for full payment history from Day 1 of loan is usually in every QWR. Many lenders have access to only the last 12, 24 or 36 mos. Not good enough.

5. 3rd most popular : copy of notice of 3-day right-to-rescind (RESPA requirement). CU's are notoriously poor at retrieving old records, especially from merged predecessors' non-computerized file cabinets.

6. CUs sometimes overreact & respond to QWRs dispatched from parents, adult children or or siblings. Each represents a host of privacy law violations.

C. The jackpot: up to \$1000.00 per item in the QWR, *plus the member's attorney fees.*

1. Each separate element or item requested can be claimed as a separate QWR. Ten numbered paragraphs in the attached model contain well over a dozen separate items or accountings: a \$12K potential recovery.

2. Lenders are forever sending "hot prints" of internally generated data screens, routinely riven with abbreviations and inconsistent usages. They either presume a member can read the data with ease, or they hope he can't, or they do not care. None is the right answer.

3. Detected paperwork deficiencies (as in I.B.3.a, above) place the lender in an impossible position:

a. produce the documents and hand the member (or his lawyer) a ready-made RESPA violation or UDAP treble-damage claim, OR

b. fail to produce it and forfeit a QWR penalty and the member's legal fees. Choose your poison.

D. QWRs which uncover paperwork deficiencies frequently inspire lenders to seek out defaulted debtors to "arrange a solution." Consumers' lawyers know it. The Internet reflects it. Expect a skeptical reply to any overture following receipt of a QWR. Expect to be held to the letter of every request.

1. Members in bankruptcy often fund their delinquencies with settlement offsets.

2. The best cases go unreported, and usually result in confidentiality requirements. Anecdotally. Confidentiality provisions often increase settlement costs 25%.

3. Sites like www.loandefects.com are a siren call to beleaguered borrowers looking for an effective shield and counterattack.

E. The “Gathering Storm” of mortgage cramdown may still pass in some form. If it does, expect a rush of Ch. 13 filings, by members wanting to stop or forestall foreclosure.

1. Claims filed on loans betraying Reg. Z violations will be disallowable.

2. HELOCs will suffer the same fate as 2nd liens on pickup trucks.

3. ARM periods, APRs, loan principal amounts, payment terms, late charges, escrow requirements, & years to repay will all be “open season” for a newly empowered Bankruptcy Court system. An October, 2005 redux awaits us.

4. Debtors in bankruptcy (Ch. 7 or Ch. 13) has access to QWRs now, as the attached example reveals.

F. **A SOLUTION:** audit every delinquent mortgage file before the first collections call, delinquency notice or late charge arises.

1. Inexpert in Reg. Z, HOEPA, RESPA, HMDA, FACTA, FCRA, or applicable state statutes? Buy the expertise & advice of an outside audit and remediate your paperwork deficiencies first.

a. Reg. Z deficiencies can be remediated whenever discovered.

b. Some loans may have to be amended or extended. Do it.

2. Some credit unions are contacting *every* mortgage account pre-emptively, to detect financial distress and accommodate account revisions. as needed. Accommodated members want TWO things:

a. Monthly payments reduced to an amount they perceive they can afford; and

b. To stay in the house.

c. APR reductions, term extensions, and balance reductions are irrelevant to them, until they get to a lawyer, Internet how-to websites, or incendiary literature tables at some local gun show.

3. If you can't remediate and you dare not foreclose, sell it to Citibank or write it off and let it sit until the member finally sells someday. Most debtors don't seek out chances to sue their credit unions. They react.

II. The "Class Action Cash Cow": NPI disclosure by lenders and its consequences.

A. FACTA, FCRA, GLB, BR 9037, federal statutes & an array of state laws (*e.g.*, NCGS §75-62 *et seq.*) all forbid disclosure or transmission of "non-public information" ("NPI") unless redacted (blacked out) or encrypted. No CU still uses SSNs as account numbers, but lenders are still being saddled with class action lawsuits seeking statutory damages.

1. Once the preserve of a few specialized law firms in the nation's greatest cities, class actions are now being threatened or filed against lenders & merchants nationwide with "cookbook complaints" downloaded or brought home from consumer's rights "boot camps."

2. Example are everywhere, and all afford guaranteed employment for platoons of lawyers:

a. more than 40 class actions filed in '07 in Chicagoland/ N. Ind. area for unredacted credit card information (expiry dates).

b. Targeted by consumer class actions for disclosure of NPI since 12/4/06:

Victoria's Secret
IKEA
Costco
The Limited
Harry & David
Bath & Body Works
Circuit City (pre Ch. 11)

c. Average penalty for each violation + \$1K (*plus attorney fees*). Suppose the qualified class contains a mere 100 members? Can you withstand a \$100K hit, before having to pay both YOUR lawyer and the plaintiffs'?

B. Where to consumers go to “get in on the action?” The Internet makes it as easy as a Capital One credit card once was.

1. Sites like www.ripoffreports.com and www.loandefects.com make sharing horror stories easy, as well as contacts with trolling class-action litigators.

a. consumers can have their loan packages scrutinized by specialists with ease, sometimes in anticipation of resultant litigation on contingency.

2. Listserv “open letters alert consumers’ sights lawyers to new opportunities daily.

C. All-too-common examples of lenders’ NPI mis-disclosures:

1. Internet lending using scans-&-e-mails instead of encrypted sites.

2. Attaching unredacted documents to Ch. 13 Proofs of Claim electronically filed with scanned attachments. BR 9037 violation.

a. Omitted contracts & documentation draws Motions to Disallow by Trustees.

b. Attached but unredacted loan applications, Loanliner “Applications Agreements and Disclosures” satisfy Trustees but trigger FACTA-violation AP’s, Motions to Seal Claims Registers and demands for supplemental attorney fees by bankruptcy lawyers. Exasperated Judges award them.

i. The debtors’ bar is building its case that lenders are disclosing NPI either deliberately or recklessly, by filing Motions to Seal Claims Registers. Repeated motions make lender’s cavalier disregard easier to demonstrate as a “pattern & practice”.

ii. US Supreme Court has ruled that a reckless disregard to FACTA/FCRA regulatory requirements can trigger willful violation damages. *Safeco v. Burr*, 2007 LEXIS 6963.

3. Inadvertent disclosure of NPI on predecessor CU’s loan documents, account statements, etc. furnished in unencrypted e-mailed replies to e-mailed requests for account histories.

4. Responses to QWR’s & UCC-9-210 account requests from unqualified parents or siblings, FDCPA verification demands mis-addressed directly to lenders, etc.

5. Too-hasty reliance upon “Word” functions to black out NPI on electronic images of documents. How it happens:

- a. CU opens a document stored in "Word", and uses a black drawing shape tool to obscure the redacted NPI.
- b. Document next converted to a PDF. Since the converted drawing shape cannot be deleted, the CU employee thinks it's "safe".
- c. Redacted document is then transmitted, released, filed as an e-exhibit,
- d. Recipient, bad guy, or anyone else can view the document in PDF, and select all the text in the area around the blacked out NPI.
- e. Recipient then pastes the selected text onto another Word or Notepad document. The black box is removed and the NPI is revealed..

D. FACTA penalties, including for NPI disclosures:

1. Negligent non-compliance: actual damages + att'y fees (15 USC §1691o)
2. Willful (now, also probably reckless) non-compliance: actual damages + punitive damages + att'y fees + statutory wards of \$100 - \$1000. (15 USC §1681n).
3. Get caught disclosing NPI, & be ready to answer for any and all members' real & imagined identity theft claims forever more.
4. Behold the consumer class actions filed against Heartland Payment Systems (USDC, D.N.J). Ch. 11 become more appealing by the day.

III. Security breaches by 3rd party vendors: "Heartache in the Heartland".

A. Heartland Payment Systems' data breach has become a litigation train-wreck.

1. At last count, approx. 625 lenders have suffered the release of customers & members' NPI. Replacements of plastics have cost a bundle.
2. Class actions against HPS have multiplied, at least one representing affected lenders in US Dist. Ct., in. NJ. (See attached 1st pg of Complaint, filed 2/20/09).
3. Others have been filed on behalf of consumers. Law firms are trolling the Internet for additional clients.
4. Potential exposure to total damage awards makes HPS a prime candidate for a Ch. 11 bankruptcy. All claimants would be general unsecured lenders.

B. Adoption of Payment Card Industry Data Security Standards (PCI DSS) has not proven perfectly effective as a shield against hackers or against class action litigation.

1. PCI - certified service providers are attempting to protect themselves and the data. Certification is a worthwhile goal, but no assurance of safety.
2. Affected CUs are as vulnerable to members' class actions as HPS is to lenders' class actions, and no more likely to survive a major damage award.
3. Require your PCI service provider to be PCI-DSS compliant.

C. Still the PCI DSS 12 core requirements furnish an excellent recipe for CUs to demonstrate to themselves and a Judge that they have pursued reasonable protective measures to protect their member's NPI. They resemble BSA policy requirements:

1. Install and maintain a fire wall configuration to protect members' NPI.
2. Do not use software vendor-supplied defaults for system passwords and other security parameters.
3. Protects stored data by minimizing the amount, evaluating each server to determine whether data storage is necessary, encrypting servers which store NPI, and assuring encryption of back-up media.
4. Encrypt transmissions of member NPI and sensitive member across public networks. Example: not assign collections matters to lawyers via unencrypted e-mails.
5. Use and regularly update antivirus software.
6. Develop and maintain secure systems and applications including installation of relevant security patches for all servers, PCs and terminals.
7. Restrict access to sensitive member data to need-to-know basis.
8. Assign a unique ID to each person with computer access, and retire that ID when employee is separated from the company for any reason.
9. Restrict physical access to members' NPI.
10. Track and monitor all access to the network resources and member NPI.
11. Regularly test security systems and processes.

12. Adopt & maintain an express written policy which address information security.

D. PCI DSS Compliance self-evaluation questionnaires are available on the Internet.

E. Require all CU's vendors & 3rd party service-providers to include 12 CFR Part 748 language in *all* contracts for services in which any access to any member NPI will be possible, to any degree.

1. Accept no substitutes. Vendors dislike compliance as will seek to shirk.
2. Most vendors furnish "canned" contracts. No contract is unamendable. Even if the text is "fixed" or pre-printed, annex a supplement to the canned contract, incorporating the annex by reference.
3. See attached example of model Part 748 language. Plagiarize as needed - AFTER inserting the other party's name for "[vendor's name here]."

F. BEWARE OF DAMAGE LIMITATION PROVISIONS IN ALL THIRD-PARTIES' "CANNED" CONTRACTS. THEY ARE UNIVERSAL AND DRACONIAN.

1. Credit Unions have earned a (undeserved ?) reputation of signing any contract any service provider places in front of them, without revision or scrutiny.
2. All 3rd parties' contracts are dreadfully, grossly one-sided against the CU, every time, always and inevitably.
 - i. "Mutual indemnity" provisions are never mutual.
 - ii. Venue restrictions to distant states and courts are as common as obscure choice-of-law provisions and arbitration-not-lawsuit terms.
 - iii. Disclaimers of functionality and fitness are universal.
 - iv. Default provisions against CU are numerous and specific, while those against vendors are few and vague.
3. Beware "liquidated damages" provisions against CU, contrasted with sorely constricted damage limitations against vendors.
 - i. Typical: CU indemnity against vendor is unlimited. Vendor's indemnity against CU is a 6-month service charge refund.
 - ii. "Deconversion" penalties and automatic term renewal provisions are ever-present.

G. Expect any 3rd party service-provider suffering data breaches to hide behind the damage limitation provision in its canned contract you signed.

1. Most Courts are unsympathetic to any claim of disproportionality of contract terms when one party is not a consumer. CU is presumed to have access to qualified legal counsel before signing any contract with anyone for anything.

2. Most lawsuits for damages resulting in data breaches are met with rapid Motions to Dismiss, Motions for Summary Judgment, Motions to Transfer Venue or similar expensive legal gymnastics.

A SOLUTION: Pay to have the contract scrutinized and interpreted for you before you sign it. The alternative is to pay much more to have it enforced or evaded later. Data breaches are inevitable. Who pays the resultant cost does not have to be.