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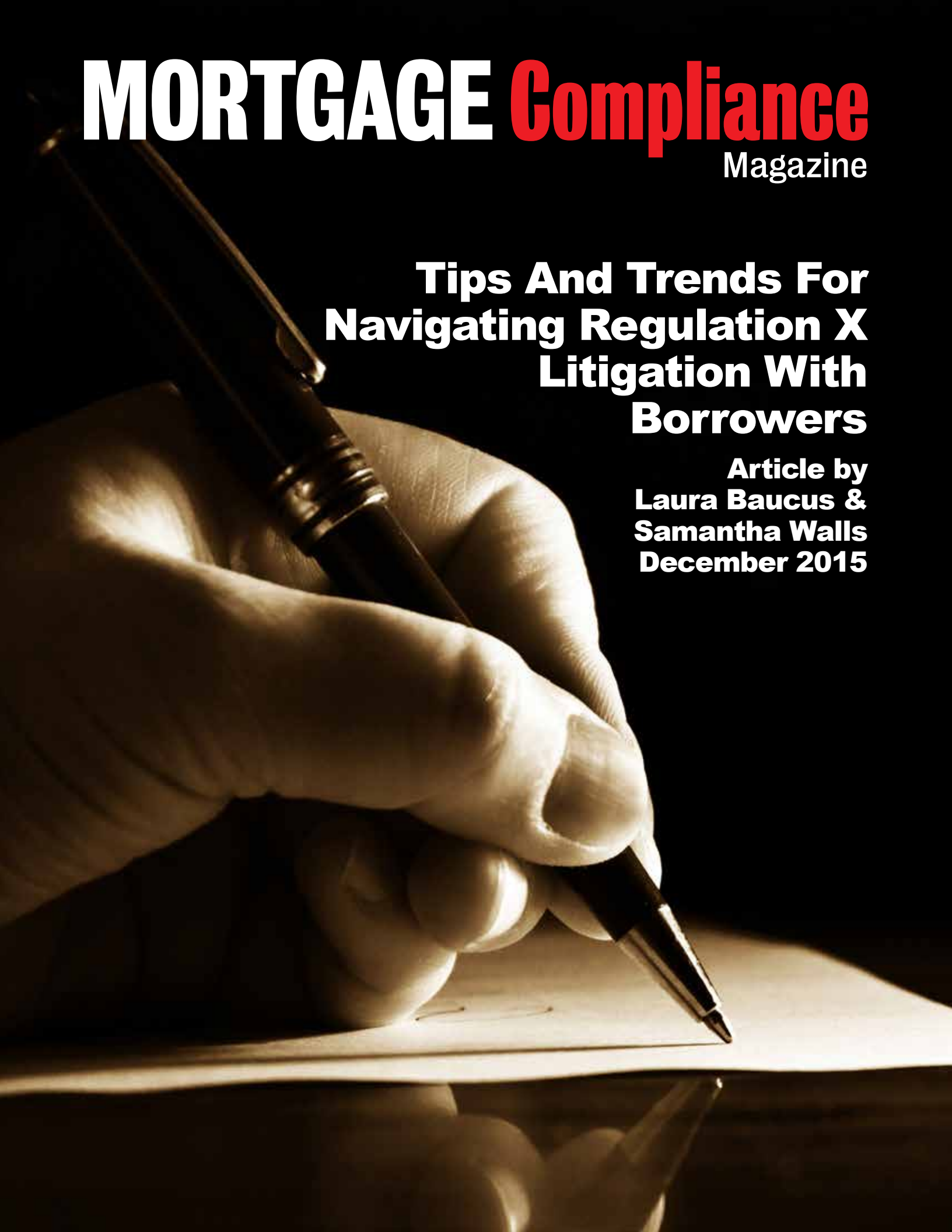

Tips And Trends For Navigating Regulation X Litigation With Borrowers

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The Consumer Financial Protection Bureau's (CFPB) Mortgage Servicing Rules under the Real Estate Settlement Procedures Act (RESPA), effective January 10, 2014 (Regulation X) opened the door for a potential wave of private, actionable litigation by borrowers arising out of perceived non-compliance with the new residential mortgage servicing rules. When implemented, the term Regulation X brought with it thoughts of unchecked litigation slowing the gears of daily servicing to a painful, grinding halt.

The question is, has Regulation X actually resulted in increased litigation by borrowers throughout the industry? The answer is a resounding "yes."; however, most judicial decisions issued involving Regulation X to date have little to do with the actual substance of the statute. Instead, courts around the country have spent much of the past year and a half figuring out the regulation's nuts and bolts: Which entities are bound by Regulation X? Who can raise Regulation X claims? Is injunctive relief an option? Has the borrower sufficiently alleged damages? Is Regulation X retroactive? Is the claim ripe or moot? Did a servicer respond reasonably to a notice of error or a request for information? Does a servicer have to respond to duplicative notices or requests?

Like most litigation involving mortgage servicing, claims relating to Regulation X are filed not only as affirmative actions by a borrower, but also as a defense to a pending foreclosure or eviction action. Not surprisingly, the majority of the decisions issued interpreting Regulation X, thus far, have been issued by federal courts. Thus far, these courts have shown willingness to dismiss Regulation X claims on motions to dismiss.

Which Entities are Bound by Regulation X? This willingness to dismiss claims does not mean all courts are in agreement about the baseline rules regarding Regulation X. In fact, we have seen courts split on at least one issue that is sure to garner more litigation as borrowers (and their lawyers) become more familiar with the ins and outs of Regulation X: Which entities are bound by ▻

Regulation X in the first place? Strictly servicers? Or investors as well under a theory of vicarious liability? A continued split on the issue could have far reaching implications for both investors and servicers in the future. Like other RESPA regulations, Regulation X does not permit claims against foreclosure counsel or its employees.

Who Can Raise Regulation X Claims? Pay attention to who is raising the Regulation X claims. Regulation X does not apply to every mortgagor of property. Instead, at least one court found that the rules apply only to the actual borrowers on the loan, not to every mortgagor or alleged successor in interest.

Is Injunctive Relief Available? The plain language of Regulation X and courts interpreting the Regulation are clear in one thing: borrowers cannot obtain injunctive relief for an alleged violation of the new rules. That being said, practitioners should be aware that borrowers continue to seek injunctive relief regularly, including seeking to halt a pending foreclosure or to set aside a completed foreclosure sale in an attempt to create law in equity on this issue.

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Have Actual Damages Been Alleged? Although injunctive relief is not available, borrowers may seek actual damages pursuant to Regulation X. The failure to plead facts supporting actual damages which—importantly—occurred after the effective date of the regulation has provided the basis for a defendant to seek the early dismissal of Regulation X claims and should be evaluated in each case.

The majority of Regulation X claims raised by borrowers, thus far, have focused on the new loss mitigation rules, notice of error rules, and request for information rules. Investors and servicers alike should keep in mind litigation trends that have started to take shape involving these rules.

§1024.41: Loss Mitigation Procedure Rules

Litigation concerning the loss mitigation section of Regulation X is undoubtedly the most prevalently filed. And why wouldn't it be? Ask anyone involved in mortgage servicing: the borrowers, servicers, or attorneys, and it is clear that the overwhelming concern of borrowers commencing litigation relates to requests for loss mitigation assistance. Regulation X's Section 1024.41 seeks to address that exact issue.

Is Regulation X Retroactive? Borrowers have rushed to bring litigation pursuant to Section 1024.41, even if their loss mitigation applications were submitted prior to Regulation X's implementation. This has led to an important area of inquiry for courts under this rule: does the regulation have retroactive effect? That is, can a borrower bring a claim if his allegations relate to events that occurred prior to the January 10, 2014, effective date? Unfortunately, the current answer is a solid "maybe."

In the most comprehensive published federal court of appeals decision interpreting whether Regulation X is retroactive, the Sixth Circuit held that when a foreclosure sale was completed prior to the regulation's implementation, Section 1024.41's loss mitigation requirements did not apply. However, at least three federal district courts have held that when the foreclosure sale was not held until after the regulation was implemented, regardless of when the loss mitigation application was initially submitted, Section 1024.41's loss mitigation rules may apply. These decisions may mean that in those (unwanted but inevitable) long-gestating foreclosures, borrowers may claim that they have the right to seek Regulation X compliance if no foreclosure sale has occurred, even if the loss mitigation application was submitted prior January 10, 2014.

Is the Regulation X Claim Ripe or Moot? As courts continue to evaluate when and how to apply Regulation X's new rules, remember that basic theories of ripeness or mootness may apply. At least one court held that a Section 1024.41 claim is not ripe prior to a foreclosure sale. Likewise, a borrower's claims may be subject to dismissal as moot if he applied more than once for loss mitigation assistance: courts have held that Section 1024.41 applies only to a first application for assistance. Finally, remember that most of the loss mitigation rules are triggered only by a borrower's submission of a complete application.

§1024.35 and §1024.36: Notices of Error and Requests for Information

Sections 1024.35 and 1024.36 of Regulation X ▻

both directly impact a borrower's ability to request and receive information concerning a loan from his servicer. Mortgage servicers might be most familiar with borrowers seeking information related to how payments were applied, or perhaps the basis amounts owed on an escrow amount. Pursuant to Regulation X, servicers are obligated to conduct an investigation into a borrower's claims, and must provide a supportable response to the concerns.

What is Reasonable? The key to satisfying Regulation X's new rules is the vague standard of "reasonableness." Was the initial investigation reasonable? Was the servicer's response to the borrower reasonable? Was the information provided in the response reasonably supported by facts? As you might imagine, what one court or jury may find reasonable could be considered unreasonable to another.

While servicers are held to a fairly strict standard in terms of their replies to notices of error and requests for information, some courts are giving borrowers more latitude in their requests. At least one court has found that the mere identification of an error is sufficient to trigger servicer response duties—even if the borrower has not provided any factual support for his claims. However, courts hopefully will continue to apply basic Federal Rule of Civil Procedure 8 requirements to pleadings, and at least one court has dismissed such claims because the allegations in the complaint were conclusory.

Similarly, even if a servicer previously responded to a notice or request, it is obligated to respond again if the prior answer was not fully responsive, or if the new request concerns the same allegations, but a different time period. This, of course, begs the question of who gets to decide when an answer is not fully responsive – a question that has not yet been fully addressed by the courts.

Does a Servicer Have to Respond to Duplicative Notices and Requests? It is not all doom and gloom when it comes to complying with these new Regulation X notice and response rules. A servicer is not obligated to respond to a duplicative request if it responded in full to the first request—even if the first request was not in the form of a formal notice of error or request for information pursuant to Regulation X.

We expect to see much more Regulation X litigation in the coming months as borrowers' attorneys become more familiar with the statute and federal district court decisions reach the appellate level. And given that certain portions of Regulation X are based on a subjective determination by the court of the validity of a servicer's attempt to comply, it may be more difficult to secure early dismissals of Regulation X claims where the reasonableness standard is involved. That being said, the tips and trends identified in this article have highlighted areas where early dismissal may be possible and should be explored. MCM

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