

No. 11-4254

IN THE

United States Court of Appeals

FOR THE THIRD CIRCUIT

DANIEL SHERZER, *et al.*,

Plaintiffs-Appellants,

— v. —

HOMESTAR MORTGAGE SERVICES, *et al.*,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

**BRIEF OF *AMICI CURIAE* AMERICAN BANKERS ASSOCIATION,
CONSUMER BANKERS ASSOCIATION, AND CONSUMER MORTGAGE
COALITION SUPPORTING APPELLEES AND AFFIRMANCE**

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CORPORATE DISCLOSURE STATEMENT

Amici curiae are all non-profit corporations headquartered in Washington, D.C. Pursuant to Fed. R. App. P. 26.1 and 29(c), none of the *amici curiae* has a parent corporation or publicly held corporation that owns 10% or more of its stock.

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INTRODUCTION

The Truth in Lending Act (“TILA”) gives certain borrowers a right to rescind their mortgage loans. Although that right typically lasts for three days from the time the loan is made, 15 U.S.C. § 1635(a), it can extend to three years if the lender fails to make certain disclosures required by TILA, 15 U.S.C. § 1635(f). But Congress was unequivocal in saying that, once those three years pass, the rescission right “shall expire.” *Id.* The Supreme Court later found these terms “so straightforward as to render any limitation on the time for seeking a remedy superfluous.” *Beach v. Ocwen Fed. Bank*, 523 U.S. 410, 417 (1998).

Despite Congress’ “manifest intent” to put rescission under TILA to rest after three years, *id.* at 410, Plaintiffs and the Consumer Financial Protection Bureau (“CFPB”) (as *amicus curiae*) now propose a new way to evade the three-year bar. They believe the period becomes irrelevant whenever a borrower files a notice of rescission with the lender within three years.

This Court has already said that “[m]ere invocation without more ... will not preserve the right beyond the three-year period [and] ... a legal action to enforce the right must be filed within the three-year period or the right will be completely extinguished.” *Williams v. Wells Fargo Home Mortg., Inc.*, 410 F. App’x 495, 499 (3d Cir. 2011) (internal marks omitted); *see also Smith v. Fidelity Consumer Discount Co.*, 898 F.2d 896, 902-03 (3d Cir. 1990). The majority of courts agree

that such suits must be brought within three years, regardless of whether the borrower filed a notice with the lender. *See Sobieniak v. BAC Home Loans Servicing, LP*, No. 11-110, 2011 WL 6122318, at *4 (D. Minn. Dec. 8, 2011) (listing cases). *Amici*—the American Bankers Association (“ABA”), the Consumer Bankers Association (“CBA”), and the Consumer Mortgage Coalition (“CMC”)—believe that these courts are right. Actions for rescission must be brought within three years.¹

Plaintiffs’ contrary approach would fundamentally undermine a statute of repose meant to promote finality and clarity. It would upset the careful balance of remedies found in TILA. It would do so for the sake of a remedy that borrowers may invoke—and often do invoke—when they are in default, when they have no genuine basis to rescind, and when they have no ability to tender the loan proceeds as required. And it would allow a borrower to strip a lender who complied with TILA of its security interest instantaneously and unilaterally. But most importantly, it would cast a shadow of uncertainty over the housing finance market, resulting in additional costs for the very borrowers that TILA was meant to benefit. The district court’s decision should be affirmed.

¹ No counsel for a party authored this brief in whole or in part. No party or counsel for a party contributed money intended to fund the brief’s preparation or submission to the Court. No person other than the *amici curiae*, their members, or their counsel contributed money to fund preparing or submitting it.

INTEREST OF THE AMICI CURIAE

Amici are three of the largest financial services trade associations in the United States. They recognize that Plaintiffs' approach to Section 1635(f) would upset the housing finance market just as it is recovering from one of the worst economic shocks in history.

The ABA is the principal national trade association of the financial services industry in the United States. Founded in 1875, the ABA is the voice for the nation's \$13 trillion banking industry and its million employees. ABA members are located in each of the fifty States and the District of Columbia, and include financial institutions of all sizes and types, both large and small.

The CBA is the only national financial trade group focused exclusively on retail banking and personal financial services—banking services geared toward consumers and small businesses. As the recognized voice on retail banking issues, CBA provides leadership, education, research, and federal representation for its members. CBA members include the nation's largest bank holding companies as well as regional and super-community banks that collectively hold two-thirds of the total assets of depository institutions.

CMC is a trade association of national mortgage lenders, mortgage servicers, and mortgage origination-service providers, committed to the nationwide rationalization of consumer mortgage laws and regulations. The CMC regularly

appears as *amicus curiae* in litigation with implications for the national mortgage lending marketplace.

ARGUMENT

I. Section 1635(f) Is a Statute of Repose That Extinguishes the Right to Rescind After Three Years, Barring Any Suit Premised on that Right.

A. *The Supreme Court has already determined that Section 1635(f) is a statute of repose.*

Section 1635(f) “completely extinguishes” the right to rescind after a given time. *Beach*, 523 U.S. at 411; *see* 15 U.S.C. § 1635(f) (“[The] right of rescission shall expire three years after the date of consummation of the transaction or upon the sale of the property, whichever occurs first[.]”). The Supreme Court has read this provision to “govern[] the life of the underlying right,” not just the time for bringing a suit to enforce it. *Beach*, 523 U.S. at 417. Because it limits the underlying right, Section 1635(f) is a statute of repose. *In re Cmty. Bank of N. Va.*, 622 F.3d 275, 301 n.18 (3d Cir. 2010). Such statutes are “less susceptible to judicial exception,” *Amoco Prod. Co. v. Newton Sheep Co.*, 85 F.3d 1464, 1472 (10th Cir. 1996), because the right that would otherwise sustain the action no longer exists, *Lieberman v. Cambridge Partners, L.L.C.*, 432 F.3d 482, 490 (3d Cir. 2005).

Statutes of repose serve a number of useful purposes. For example, such statutes require suits to be filed in a timely fashion, before the “basic facts may

have become obscured by the passage of time.” *United States v. DiSantillo*, 615 F.2d 128, 136 (3d Cir. 1980). They also relieve parties of a continual fear of indefinite liability by providing some degree of certainty as to the end point of liability. *See In re Exxon Mobil Corp. Sec. Litig.*, 500 F.3d 189, 199-200 (3d Cir. 2007) (“[T]here is a time when allowing people to put their wrongful conduct behind them—and out of the law’s reach—is more important than providing those wronged with a legal remedy[.]”); *Robinson v. Hartzell Propeller, Inc.*, 454 F.3d 163, 173 (3d Cir. 2006) (explaining that statutes of repose “are designed primarily to protect private parties from liability on stale claims”); *Woessener v. Air Liquide Inc.*, 242 F.3d 469, 473 (3d Cir. 2001) (stating that a statute of repose “literally confers immunity” after a given time).

B. Plaintiffs’ interpretation would strip Section 1635(f) of its force as a statute of repose while compelling the Court to enforce an expired right.

Plaintiffs and the CFPB argue that a court may enforce a right extinguished by Section 1635(f). But in *Williams v. Wells Fargo Home Mortgage, Inc.*, 410 F. App’x 495, 499 (3d Cir. 2011),² this Court concluded that “[m]ere invocation without more, however, will not preserve the right beyond the three-year period.”

² Although unpublished, the facts of *Williams* are similar to this case. Therefore, the Court may “look to the decision as a paradigm of the legal analysis that [it] should here follow.” *Drinker by Drinker v. Colonial Sch. Dist.*, 78 F.3d 589, 864 n.12 (3d Cir. 1996).

Relying principally on the Supreme Court's decision in *Beach, Williams* determined that "a legal action to enforce the [rescission] right must be filed with three-year period or the right will be completely extinguished." *Id.* (internal marks omitted); *see also Fidelity Consumer Discount Co.*, 898 F.2d at 902-03 (looking to the time the action was filed to determine timeliness under Section 1635(f)).

Were this Court to repudiate *Williams* and embrace Plaintiffs' position, Section 1635(f) would no longer achieve the purposes of a statute of repose. Stale cases would become common unless lenders simply caved to pressure to settle. And as the CFPB concedes in a footnote to its brief, the section would no longer provide the certainty of a repose period.³ *See* CFPB's Br. 26 n.6, ECF No. 003110869200. If courts determined to "borrow" limitations periods from other statutes, as the CFPB suggests, lenders would be forced to guess at the applicable limitations period. Courts could borrow from *state* limitation periods, destroying the uniform application of this statute of national reach. Lenders would then be forced to wrestle with perhaps 50 different standards in 50 different states. This patchwork of periods would be detrimental to housing finance and the cost and flow of mortgage credit to consumers.

³ Plaintiffs try to resolve this self-created problem by looking to the one-year statute of limitations found in 15 U.S.C. § 1640. *See, e.g.*, Pls.' Br. 14, 17, ECF No. 003110860535. But Section 1640 applies only to claims for *damages*, not claims for rescission. *See* 15 U.S.C. § 1640(a). Nor does it apply if the claim is raised as a defense by recoupment or set-off. *Id.* § 1640(e).

Perhaps more fundamentally, courts have never assumed the role of enforcing a right that has already been extinguished. A cause of action consists of “the unlawful violation of a right which the facts show.” *Am. Fire & Cas. Co. v. Finn*, 341 U.S. 6, 13 (1951). A plaintiff must have a valid cause of action (and a present entitlement to enforce it) to bring a suit. *McMahon v. United States*, 186 F.2d 227, 230 (3d Cir. 1951). But by virtue of Section 1635(f), a plaintiff suing after the critical three-year mark lacks the right necessary to support the suit—whether the borrower sought to privately assert that remedy before bringing suit or not. *See McOmie-Gray v. Bank of Am. Home Loans*, 667 F.3d 1325, 1329 (9th Cir. 2012).

The CFPB attempts to recharacterize Plaintiffs’ suit as a quasi-declaratory judgment action concerning a borrower’s unilateral act. *See* CFPB’s Br. 15-17. That is not the law. Absent mutual assent of the parties, “[r]escission involves a judicial termination of a party’s contractual obligations; it is a court-ordered ‘unwinding’ of a contract.” *Jones v. InfoCure Corp.*, 310 F.3d 529, 535 (7th Cir. 2002). Several courts have applied this principle in the TILA context, holding that a unilateral notice of rescission does not automatically rescind a mortgage. *See, e.g., Am. Mortg. Network, Inc. v. Shelton*, 486 F.3d 815, 821 (4th Cir. 2007); *Yamamoto v. Bank of New York*, 329 F.3d 1167, 1172 (9th Cir. 2003); *Large v. Consec Fin. Servicing Corp.*, 292 F.3d 49, 55 (1st Cir. 2002). These courts agree

that, where a lender disagrees with a borrower’s purported rescission, a borrower has only advanced a *claim* for rescission until the relevant decisionmaker decides whether the conditions for rescission have been met. *Large*, 292 F.3d at 55.

II. Plaintiffs’ Interpretation of Section 1635(f) Would Cause Substantial Harm to Lenders, Borrowers, and Courts.

A. Plaintiffs’ interpretation would open the floodgates to meritless litigation.

Plaintiffs’ approach would further ensure that courts would be forced to grapple with largely groundless rescission suits for years to come. Indeed, the enormous body of recent rescission-related case law cited by the parties and the CFPB reflects the substantial growth in rescission litigation in the wake of the financial crisis. Plaintiffs’ interpretation would ensure that courts remain overwhelmed.

Furthermore, in the experience of *amici* and their members, TILA rescission claims frequently lack merit. Borrowers often raise such claims on the eve of bankruptcy or in the midst of a foreclosure proceeding in a last ditch effort to avoid enforcement of their obligations. These borrowers rarely have the ability to “return the loan principal” as TILA requires. *Marr v. Bank of Am.*, 662 F.3d 963, 966 (7th Cir. 2011) (“[T]his requirement often has the practical effect of ruling out

rescission[.]”).⁴ Often there is no TILA violation at all. In the context of litigation, these defects may be quickly identified and non-meritorious claims may be dispensed with efficiently. What is more, the requirement of litigation imposes some discipline on potential plaintiffs, requiring them to consider whether it is worth investing time and money in futile claims.

Allowing a rescission action to proceed at any juncture without limitation, so long as a notice was filed within three years, creates a perverse incentive for borrowers to “pre-file” a notice of rescission before the three-year period expires. The borrower could then hold that right of rescission indefinitely, until it becomes useful. If, for instance, the lender later chose to foreclose, the borrower might try to assert a tardy recoupment claim (while avoiding the decision in *Beach* by invoking the notice). The lender could not even borrow statutes of limitations from elsewhere to defeat the recoupment claim, as statutes of limitation generally do not bar the use of stale claims brought defensively. *See, e.g., Silverman v. Eastrich Multiple Investor Fund, L.P.*, 51 F.3d 28, 32 (3d Cir. 1995). The lender’s only option to avoid this problem would be to litigate the matter itself, immediately

⁴ “[A]n underwater TILA plaintiff typically cannot refinance her mortgage, and the sale of her home usually cannot generate sufficient proceeds to fully finance the borrower’s tender obligation.” Lee Krivinkas Shepard, *It’s All About the Principal: Preserving Consumers’ Right of Rescission Under the Truth in Lending Act*, 89 N.C. L. Rev. 171, 181 (2010).

upon receiving the rescission notice, by bringing its own costly action every time a rescission notice is filed—even if the notice is facially without merit.

B. Plaintiffs' interpretation would transform rescission into an equitable remedy that produces fundamentally inequitable results.

Rescission is an equitable remedy guided by equitable principles. *See, e.g., Erie Telecomms., Inc. v. City of Erie*, 853 F.2d 1084, 1091 (3d Cir. 1988); *accord Brown v. Nat'l Permanent Fed. Sav. & Loan Ass'n*, 683 F.2d 444, 447 (D.C. Cir. 1982) (“[Although] statutorily granted[,] ... [TILA rescission] remains an equitable doctrine subject to equitable considerations.”). In fact, Congress underscored the equitable nature of TILA rescission by empowering courts to develop their own procedures for administering the remedy. *Jobe v. Argent Mortg. Co., LLC*, 373 F. App'x 260, 262 (3d Cir. 2010) (citing 15 U.S.C. § 1635(b)). Courts have also read requirements into TILA rescission that are supported primarily by equitable (rather than textual) considerations. *See, e.g., Shelton*, 486 F.3d at 821 (relying on equitable considerations to hold that courts may condition rescission on ability to tender); *Yamamoto*, 329 F.3d at 1171-73 (same).

Congress could not have intended an equitable remedy to create substantial inequities, but that is exactly what Plaintiffs' reading threatens to do here. A fundamental premise of the Plaintiffs' argument is that the rescission is complete upon notice from a borrower. Were this true, the lender's security interest would become instantly void by law, 15 U.S.C. § 1635(b), even if the notice were not

valid, *Yamamoto*, 329 F.3d at 1172.⁵ This result makes sense in the context of rescission within the three-day “cooling-off period,” where the right is unconditional, funds have not been disbursed, and the security interest has not been recorded. But such a result is not equitable after those first three days, when the right becomes conditional, funds have been disbursed, and the security interest recorded. “Clearly it was not the intent of Congress to reduce the mortgage company to an unsecured creditor or to simply permit the debtor to indefinitely extend the loan without interest.” *Shelton*, 486 F.3d at 820-21.

This is not to suggest that Congress left borrowers without *any* remedy after the three years pass; to the contrary: Section 1640(a) specifically contemplates a damage award for a violation of the TILA rescission provision. *See* 15 U.S.C. § 1640(a) (permitting damages for a failure to comply with “any requirement under Section 1635”). Consequently, if a borrower could establish that a creditor wrongfully refused to rescind, the borrower could still receive both actual and statutory damages. But that relief, unlike the rescission right, would not present a potential cloud over a property’s title for years to come. Congress anticipated that borrowers would receive a measure of relief, but not by warping the rescission

⁵ This would cause significant complications for a lender. For instance, a lender facing a rescission notice might be forced to reduce its regulatory capital, as secured debt is treated differently from unsecured debt in calculating required capital levels. *See* 12 C.F.R. pt. 3, appendix A § 3 & table 1.

right into a never-ending cause of action that imposes significant expense on the creditor and the marketplace.

Plaintiffs ask this Court to rely on a highly technical reading of Section 1635(f) that is divorced from the broader statutory context.⁶ Yet TILA is an interconnected and comprehensive scheme. *See, e.g., Christ v. Beneficial Corp.*, 547 F.3d 1292, 1297-98 (11th Cir. 2008). Its remedial provisions must be read together. When they are, Congress' intent becomes clear: rescission should be treated as a limited and controlled remedy, while ample other remedies remain available to the borrower. That Plaintiffs' view of this equitable remedy would create gross inequities further evidences that Plaintiffs' approach could not have been what Congress intended. Plaintiffs' approach should therefore be rejected.

C. Plaintiffs' interpretation would upset the careful balance of remedies found in TILA.

Plaintiffs' misguided approach also upsets the delicate balance that Congress struck in the statute. Legislatures often use statutes of repose to strike a "legislative balance" to service the "economic best interest" of the public. *Jones v. Saxon Mortg., Inc.*, 537 F.3d 320, 327 (4th Cir. 1998). That balance should not be lightly upset. This is especially so in the TILA context, where Congress has taken

⁶ Certain other courts have incorrectly taken such an approach. *See, e.g., Gilbert v. Residential Funding LLC*, No. 10-2295, 2012 WL 1548580, at *5 (4th Cir. May 3, 2012), *petition for reh'g filed* No. 10-2295 (May 17, 2012).

special care to balance competing purposes and deliberately limited certain remedies to achieve that balance. *See, e.g., Turner v. Beneficial Corp.*, 242 F.3d 1023, 1025 (11th Cir. 2001) (“Congress has amended TILA to ensure that it provides for a fair balance of remedies.”).

Congress crafted the right of rescission to give borrowers a limited chance to reconsider their decision to enter into certain credit transactions involving their homes. Rescission, however, is a “restorative rather than compensatory remedy,” *Andrews v. Chevy Chase Bank*, 545 F.3d 570, 575 (7th Cir. 2008), and was not designed for recurrent use. In fact, Congress enacted higher “tolerance” levels for TILA disclosure violations in 1995 partly because it was concerned that rescission, the “most draconian remedy available under [TILA],” had become too common and threatened too much liability on the lenders. *McKenna v. First Horizon Home Loan Corp.*, 475 F.3d 418, 424 (1st Cir. 2007) (quotation marks omitted).

Plaintiffs’ interpretation would push this “draconian remedy” well beyond the balance of interests carefully struck by Congress. Because rescission is effectively an “interest-free loan[,] ... the longer one allows the right of rescission to be exercised, the greater the benefit to the consumer, and the greater the penalty to the creditor.” Daniel Rothstein, *Truth in Lending: The Right to Rescind and the Statute of Limitations*, 14 Pace L. Rev. 633, 657 (1994). By permitting a borrower to rescind upon notice, the borrower could pre-file a notice and then—years later—

seek the return of all their payments and interest, having lived rent-free at the expense of the lender. This would disrupt both the equipoise Congress intended and the long-established expectations of the participants in our nation's housing finance market.

D. Plaintiffs' interpretation would increase uncertainty, litigation costs, and risk, resulting in higher costs for borrowers.

Plaintiffs' interpretation would increase uncertainty and risk in the marketplace. Even the logistics of effecting a rescission by notice creates uncertainty; unlike a lawsuit, a borrower's notice might be lost or misdirected and a lender might never become aware of the purported rescission. So long as the borrower was willing to allege that he had mailed a rescission notice within three years from closing, the borrower would enjoy an indefinite right to rescind. A lender or subsequent holder could never be confident that its security interest was clear and might always face the prospect of being reduced to unsecured status.

Such uncertainty has real consequences for the lending market. The secondary mortgage market,⁷ for instance, can only deliver a steady supply of reasonably-priced loans if securitizers and investors can be certain that loans are

⁷ "Commentators have estimated that the existence of an efficiently operating secondary mortgage market may reduce the cost of home mortgage credit by up to two percent." Franklin D. Cordell, *The Private Mortgage Insurer's Action for Rescission for Misrepresentation: Limiting a Potential Threat to Private Sector Participation in the Secondary Mortgage Market*, 47 Wash. & Lee L. Rev. 587, 593 (1990) (footnote omitted).

valid and enforceable. Likewise, buyers will only be willing to purchase homes coming out of foreclosure if they can be confident that they are taking clear title. But Plaintiffs' view of the rescission right would likely "cloud the bank's title on foreclosure." *Beach*, 523 U.S. at 418.

Adopting Plaintiffs' approach would increase the costs to lenders and their assignees on every loan in other ways. Ultimately, these costs would be borne by borrowers at the closing table. Lenders would be expected to incur additional litigation expenses. Litigation would increase not just between lenders and borrowers, but also between (a) lenders themselves; (b) secondary market participants and lenders; and (c) home buyers and home sellers. TILA rescission also serves an "insurance function for consumers" that "increase[s] the seller's marginal costs," which will "tend to raise the price" for the loan. Michael Aikens, *Off-Contract Harms: The Real Effect of Liberal Rescission Rights on Contract Price*, 121 Yale L.J. Online 69, 79 (2011). Plaintiffs' approach would expand both the reach and the potential payout of the insurance, further increasing costs.

CONCLUSION

The law is clear as to how the statute of repose limiting the rescission remedy should operate; practical and equitable considerations counsel the same result. Both law and policy indicate that the district court should be affirmed.

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CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing document was served on June 1, 2012 via ECF on the counsel listed below. Ten paper copies have been dispatched to the Court on June 1, 2012. Paper copies have also been mailed to the counsel listed below via First Class mail sent June 1, 2012.

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Michael R. Williams

CERTIFICATION

I hereby certify that (1) the ECF submission is an exact copy of the paper documents filed with the Court; (2) the ECF submission was scanned for viruses using TREND MICRO OfficeScan version 10.5.1997 with an update on May 29, 2012 and, according to the program, the document is free of viruses; and (3) Kirk Jensen and I are members of the bar of this Court.

/s Michael R. Williams
Michael R. Williams