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WHAT'S INSIDE

SOVEREIGN IMMUNITY

Judge tosses suit over IRS penalties on foreign bank account

Two taxpayers cannot proceed with a lawsuit challenging $51,000 in penalties assessed by the IRS for failure to declare funds in an offshore bank account, a Wisconsin federal judge has ruled.

Kentera et al. v. United States, No. 16-cv-1020, 2017 WL 401228 (E.D. Wis. Jan. 30, 2017).

U.S. District Judge J.P. Stadtmueller of the Eastern District of Wisconsin said sovereign immunity shielded the government from Milo and Lois Kentera's claims brought under the Administrative Procedure Act, 5 U.S.C.A. § 701, which provides for judicial review of federal agency actions under certain conditions.

He said the Kenteras could not sue the government under the APA because they had another legal remedy available.

THE OFFSHORE ACCOUNT

According to the opinion, the Kenteras have held an account at Banque Cantonale de Geneve, a Swiss bank, since 1984 and until 2006 reported this account on their federal income tax returns.

The Bank Secrecy Act, 31 U.S.C.A. § 5311, requires U.S. citizens to file reports when they hold an account with an offshore bank. The disclosure is made on an IRS form called a Report of Foreign Bank and Financial Accounts, or FBAR.

The accountants who prepared the couple's tax returns for the years 2006 through 2010 did not report the account and the IRS assessed a total of $51,000 in penalties against the Kenteras, the ruling said.

REASONABLE CAUSE

The plaintiffs sued the United States, alleging violations of the APA and their due process rights under the Fifth Amendment.

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CFPB 2016 roundup: Mortgage enforcement trends and enforcement authority examined

Allison Schoenthal and Gregory Lisa of Hogan Lovells offer a summary of the Consumer Financial Protection Bureau's enforcement actions and the challenges to its authority occurring in the past year.

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Director:
Mary Ellen Fox

Editors:
Catherine A. Tomasko
Cath.Tomasko@thomsonreuters.com

Tricia Gorman

Managing Desk Editor:
Robert W. McSherry

Desk Editors:
Jennifer McCreary, Katie Pasek,
Sydney Pendleton, Maggie Tacheny

Graphic Designers:
Nancy A. Dubin, Ramona Hunter

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Thomson Reuters
175 Strafford Avenue, Suite 140
Wayne, PA 19087
877-595-0449
Fax: 800-220-1640
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CFPB 2016 roundup: Mortgage enforcement trends and enforcement authority examined

By Allison Schoenthal, Esq., and Gregory Lisa, Esq.
Hogan Lovells

Last year the CFPB initiated only five public enforcement actions in the mortgage industry. This is a dramatic drop from the 15 public actions initiated against mortgage lenders and servicers in 2015.

The Bureau made it very clear though that it has not taken its eye off the mortgage industry. In addition, the Bureau remained engaged in a steady stream of federal court cases that have the potential to shape the parameters of its enforcement authority.

Below we review the CFPB's 2016 enforcement activity in the mortgage industry, federal court decisions that established significant legal precedents in 2016, and the potential effects of the change in presidential administrations on the Bureau.

MORTGAGE INDUSTRY ENFORCEMENT SHIFTS BUT DOES NOT CEASE

The pace of newly-initiated CFPB enforcement actions — whether filed as a settled action or as a pending complaint — slowed generally in 2016, with 42 actions compared to 57 in 2015.[1] However, actions filed against mortgage originators and servicers also fell as a percentage of the CFPB's total actions.

The five actions filed against participants in the mortgage industry represented just 11.9% of the CFPB's total enforcement actions in 2016, down from approximately 26% in 2015.

From 2013-2015, there were more enforcement actions in the mortgage industry than in any other single industry. This was no longer the case in 2016.

> The Bureau has made it very clear that it has not taken its eye off the mortgage industry.

Although significant, this change should not be read to mean that the CFPB is backing off its aggressive scrutiny of the mortgage industry, because the CFPB continues to actively police the industry by other means.

The CFPB's public enforcement activity in the mortgage industry slowed, but did not stop

The five cases filed against participants in the mortgage industry in 2016 included a settled administrative proceeding with David Eghbali, a Wells Fargo loan officer who the CFPB found engaged in an illegal kickback scheme in violation of the Real Estate Settlement Procedures Act (RESPA).

The CFPB also filed a fair lending case against BancorpSouth Bank in conjunction with the U.S. Department of Justice's Civil Rights Division that alleged that BancorpSouth's underwriting and pricing practices discriminated against African-American mortgage applicants living in certain neighborhoods (such discriminatory lending practices are often referred to as "redlining").

Finally, the CFPB settled actions with three reverse mortgage lenders — all on the same day — resolving allegations that the companies employed deceptive advertisements that falsely represented, among other things, that the reverse mortgages could not cause them to lose their home.

The Bureau's publicly-filed enforcement actions largely targeted other industries in 2016. Fifteen (35.7%) of the actions the CFPB filed related to payday, pawn shop, or title loans. Eight actions (19.1%) related to debt collection practices, three (7.1%) to student loans or student debt relief, and another three (7.1%) to consumer lending including auto loans.

The CFPB filed a pair of actions in each of three other industries: consumer banking; credit cards; and third-party payment processing.

Finally, the Bureau filed a single action relating to credit repair services and one addressing the practices of a company that purchases structured settlements from consumers.

Allison Schoenthal (L), is a partner in the New York office of **Hogan Lovells**, where she is head of the firm's consumer finance litigation practice. She regularly represents banks and financial institutions in enforcement matters and provides compliance advice and risk assessments. She can be reached at allison.schoenthal@hoganlovells.com. **Gregory Lisa** (R), is a partner in the firm's Washington office, where he represents financial institutions and individuals in anti-money laundering, consumer protection and white collar criminal defense matters. He previously served in the enforcement office at the Consumer Financial Protection Bureau, as the interim director of the Office of Compliance and Enforcement at the Treasury Department's Financial Crimes Enforcement Network and for 10 years as a prosecutor with the U.S. Department of Justice. He can be reached at gregory.lisa@hoganlovells.com. The authors wish to thank Rebecca Umhofer for her contributions to this article. Reprinted with permission.

Behind the slower pace of new enforcement actions

In early 2015, there were reports that the CFPB had slowed its pace of opening new investigations in order to focus on clearing a back-log of open cases.[2] The general drop in newly initiated cases this past year may be a ripple effect of the 2015 effort to resolve pending investigations.

While focusing on existing cases, the Bureau likely opened fewer enforcement investigations in 2015 and the resulting smaller pipeline of open investigations could be expected to produce fewer publicly-filed administrative and district court enforcement actions in 2016.

> The CFPB also seems to be increasingly relying on the rule-making process to shape the mortgage industry's interactions with consumers.

Because the CFPB generally aims to resolve cases within two years of opening an investigation[3] and the majority of the investigations are simultaneously publicly-disclosed and settled, the large number of reported mortgage enforcement actions in 2015 may have grown out of complaints fielded as early as 2013 — when mortgage complaints were the highest both in real numbers and as a percentage of all complaints received by the CFPB.

CFPB employs other means to police the mortgage industry

At least with regard to the mortgage industry, the CFPB also seems to be increasingly relying on the rule-making process to shape the industry's interactions with consumers.

According to a February 2016 fact sheet, the Bureau's near term priorities in the mortgage industry are:

- Working through the Bureau's supervisory and enforcement programs to ensure equal and fair (non-discriminatory) access to mortgage credit.
- Ensuring that the new Home Mortgage Disclosure Act (HMDA) rule is successfully implemented.
- Implementing mortgage servicing rules, protecting delinquent borrowers still suffering from the aftermath of the financial crisis or other economic setbacks, and ensuring that servicers are equipped to handle any future delinquencies fairly.
- Supporting implementation of the mortgage rules and beginning to assess the effectiveness of significant rules.

Last year, the CFPB issued several pieces of guidance and rules that appear to align with these stated goals.

First, the Bureau announced that "redlining examinations are generally scheduled at institutions where the Bureau has identified statistical disparities" that suggest discrimination but added that "statistics are never considered in a vacuum."[4] It also laid out the factors supervisory examiners will use to assess redlining risk.

These factors include: The strength of the institution's Compliance Management Systems (CMS); Unique attributes of the relevant geographic areas; Lending patterns; Peer and market comparisons; Physical presence (full service branches, ATM-only branches, brokers, correspondents, loan production offices); Marketing; Mapping (Community Reinvestment Act assessment area and market area more generally); Lending policies and procedures; Additional evidence (whistleblower tips, loan officer diversity, testing evidence, comparative file reviews); and an institution's explanation for any apparent differences in treatment.[5]

In addition, the CFPB finalized regulations implementing HMDA that will modernize the way lenders publicly report mortgage data when they take full effect in 2018 and has published numerous webinars and other resources to aid in implementing the new rules.

On July 29, 2016, the Bureau also proposed a handful of changes to the Know Before You Owe mortgage disclosure rule, which had taken effect in October 2015.[6] The CFPB is currently reviewing the comments to the proposed rule changes and a final rule is forthcoming.

Finally, the Bureau finalized changes to the loan servicing rules.[7]

Beyond creating new rules and public enforcement actions, the CFPB can also police corporate behavior by issuing warning letters and through supervisory examinations.

In the past, Bureau warning letters sometimes foreshadowed enforcement actions relating to the topic of the letters — to some extent a "warning shot" to the industry to rectify noncompliance issues.

For instance, in 2015, the CFPB issued warning letters to several undisclosed companies, advising them that student debt relief scammers may be targeting student loan borrowers through their search products.

Subsequently, in March 2016, the CFPB settled a case with the Student Aid Institute for practices that allegedly deceived customers about the benefits and fees associated with student debt relief programs.

On October 27, 2016, the CFPB announced that it had issued warning letters to 44 mortgage lenders and brokers informing them that they may be in violation of the HMDA's requirements to collect, record and report data about their housing-related lending activity.

The sample letter released by the Bureau indicates that the CFPB has not yet concluded whether the recipient has violated the HDMA but preserves the Bureau's right to file enforcement actions so alleging in the future.

We will be watching to see if the CFPB files enforcement actions relating to HDMA requirements in 2017.

In contrast to public enforcement actions, the Bureau's supervisory examinations frequently lead to Board resolutions or confidential memoranda of understanding through which institutions agree to correct and/or remediate problems identified by examiners.

Although such actions are aggregated and generally described in CFPB advisories and other reports, the individual supervisory agreements between examiners and financial institutions themselves are not made public.

Insight into the CFPB's supervisory exams of the mortgage servicing industry can be found in a special edition of the CFPB's Supervisory Highlights, published in June 2016, which reports solely on supervisory findings relating to mortgage servicing (The Special Edition Report).[8]

That publication notes that "[s]upervisory examinations of mortgage servicers now generally focus on reviewing for compliance with [the CFPB's servicing rules] and for unfair, deceptive and abusive acts or practices."

As noted above, the CFPB recently reconfirmed that fair lending is a priority and the Special Edition Report indicates that in accordance with this priority, the CFPB has been collecting baseline data relating to the Equal Credit Opportunity Act (ECOA), and anticipated conducting more comprehensive ECOA Target Reviews of mortgage servicers in 2016.

Service transfers have also been of interest to the CFPB and the Special Edition Report recognizes that servicers appear to be making progress with regard to honoring loss mitigation agreements when loans are transferred.

Although problems persist, the report explains that some servicers have improved their transfer policies, procedures and practices in ways that enable them to identify more "in-flight modifications," which are granted by one servicer as the loan is being transferred to another.

According to the Special Edition Report, the CFPB continues to be concerned about the legal violations identified at various servicers particularly in the areas of loss mitigation and servicing transfers but also recognizes "significant improvements in the last several years."

The Bureau attributes these improvements to enhanced monitoring and servicing of technology platforms, staff training, coding accuracy, auditing and allowing for greater flexibility in operations.

The Special Edition Report expresses concern about outdated and deficient servicing technology and a lack of proper training, testing and auditing of technology-driven processes.

The report then catalogs problematic practices, the vast majority of which were previously identified as compliance problems in earlier quarterly Supervisory Highlights reports. They involve: loss mitigation acknowledgement notices; loss mitigation offer letters and related communications; loan modification denial notices; servicing policies, procedures and requirements; and servicing transfers.

CFPB Director Richard Cordray underscored these concerns in a speech to the Mortgage Bankers Association in October 2016. There, he explained that while some servicers have invested heavily in compliance, others continue to employ "[o]utdated and deficient servicing technology" that puts consumers at risk.

He noted that this problem is made worse by a lack of proper training for employees and that "[t]hese shortcomings can become chronic when servicers do not implement proper system testing and auditing processes."

> The CFPB can police corporate behavior by issuing warning letters and through supervisory examinations.

Director Cordray also announced that the Bureau would, "in appropriate circumstances, be insisting on specific and credible plans from servicers describing how their information technology systems will be upgraded and improved to resolve these issues effectively."

In sum, the mortgage servicing industry can expect the CFPB to focus on potential deceptive practices, fair lending, service transfers, and testing of technology in future exams.

Supervisory Highlights reports published in 2016[9] also reported on supervisory examinations of mortgage originators. Such examinations focused on compliance with Title XIV rules, the Truth in Lending Act (TILA) and Real Estate Settlement Procedures Act (RESPA) disclosure provisions and found general, though imperfect, compliance with these laws.

Examiners, however, noted that many entities continue to have deficiencies in their CMS. These problems were specifically attributed to weak oversight of automated systems and inadequate testing of codes used to calculate finance charges and the amount financed when originating residential loans.

In addition, some entities failed to monitor for changes in federal consumer financial laws that would require updated disclosures.

Beyond the CMS deficiencies, supervisory examiners found one or more compliance problems relating to:

- Failure to maintain written policies and procedures required by the loan originator rule;
- Incorrectly calculating the amount financed on loans with discount credits, and subsequently incorrectly calculating the finance charge on the same loans;
- Failing to properly verify consumers' income relied upon in calculating their monthly debt-to-income ratio; 4) Failing to provide timely required disclosures to consumers;
- Failing to comply with provisions of RESPA Section 8 and its implementing Regulation X that prohibit the acceptance of any fee, kickback or other thing of value in exchange for a referral;
- Failing to provide notice consistent with requirements of Fair Credit Reporting Act to consumers after taking adverse action against them based on information in the consumer's "consumer report;"
- Relying on employees of third parties, who are not properly registered or licensed to work as loan originators; and
- Failing to properly disclose interest on interest-only loans.

The dramatic drop in CFPB complaints filed against mortgage industry actors does not reflect a lack of CFPB scrutiny of the industry. The CFPB's supervisory examiners continue to make important observations about compliance by mortgage servicers and originators — and continue to impose nonpublic supervisory requirements to address compliance problems.

Moreover, the Bureau issued a number of policies and regulations of key importance to mortgage lenders and servicers this past year.

Although the CFPB initiated fewer new enforcement actions across all industries in 2016, its lawyers and other staff members appear to be busy. Cases that have been pending in federal courts for several years produced a number of significant legal precedents this year.

We address those noteworthy decisions below, as well as the potential effects of the

Trump Administration and new (or renewed) legislative initiative from the Congress.

COURTS WEIGH IN ON SCOPE OF CFPB'S ENFORCEMENT AUTHORITY

Although the CFPB was less active in resolving enforcement actions in 2016, the number of cases pending in federal court that have the potential to shape the parameters of the Bureau's enforcement authority remained relatively steady.

The CFPB was a party to 36 actions filed in federal courts in 2015 and 32 filed in 2016. There are currently 43 open federal court cases involving the CFPB — 35 filed by the CFPB as plaintiff (or petitioner to enforce a civil investigative demand) and 8 naming the CFPB as a defendant.

A close examination of the CFPB's docket reveals a slight uptick in defense work for the CFPB.

In 2015, one case challenged the Bureau's authority to interview the plaintiff's former attorney and two Freedom of Information Act (FOIA) complaints were filed against the Bureau. In contrast, three new suits challenging the CFPB authority or structure and four FOIA cases were filed against the Bureau in 2016.

And the reduced volume of new cases in 2016 may be more than offset by the import of the issues raised in by new and old cases on the CFPB's docket last year.

Significantly, the federal courts issued a number of opinions addressing the scope of the CFPB's enforcement authority during 2016. These include:

- The D.C. Circuit Court's ruling that the CFPB's single-director-removable-only-for-cause structure is unconstitutional;
- The same court's holding that the CFPB violated due process by retroactively applying a new statutory interpretation that departed from prior government guidance;
- Again, the same court's holding that the Bureau's administrative proceedings are subject to a statute of limitations, contrary to the Bureau's arguments;
- Decisions suggesting that ratification of actions taken while the Bureau operated unconstitutionally may preserve the validity of those actions;
- A ruling that limited the CFPB's civil investigative demand (CID) authority; and
- A decision affirming the Bureau's ability to rely on state law violations to support an enforcement action alleging a "deceptive act" and disregarding formalities in favor of a "true lender" analysis to identify what state laws apply to particular loans.

Each holding is discussed in greater detail below.

D.C. Circuit rules that the CFPB's structure is unconstitutional but leaves its operations largely unchanged

In *PHH Corp. v. Consumer Financial Protection Bureau*, 839 F.3d 1 (D.C. Cir. Oct. 11, 2016), the D.C. Circuit held that the CFPB's current structure was unconstitutional.

The court, however, adopted a narrow remedy by severing a single provision of the act that established the CFPB. That provision provided that the director could be removed from his five-year term of service only for cause.

> In sum, the mortgage servicing industry can expect the CFPB to focus on potential deceptive practices, fair lending, service transfers, and testing of technology in future exams.

The D.C. Circuit ruled that an independent agency headed by a single director, who is not accountable to the President, violated the Constitution's Separation of Powers Clause.

However, the court went on to remedy this violation by declaring that "[t]he CFPB will now operate as an executive agency. The President of the United States now has the power to supervise and direct the Director of the CFPB, and may remove the Director at will at any time." *Id.* at 39.

The CFPB has petitioned the D.C. Circuit for en banc review of the *PHH* separation of powers decision, setting up what "may be the most important separation-of-powers case in a generation." *See* CFPB's Petition for Rehearing En Banc at 1, *PHH Corp. v. Consumer Financial Protection Bureau*, No. 15-1177 (D.C. Cir. Nov. 18, 2016) (CFPB Petition).

The D.C. Circuit is likely to rule on that petition in early 2017. If the D.C. Circuit declines to review the decision en banc, the government will have 90 days to file a writ of certiorari seeking review by the U.S. Supreme CourtThe CFPB Petition also seeks review of the *PHH* court's RESPA holding, which vacated a $103 million increase to a $6 million fine originally levied against PHH for alleged RESPA violations. The alleged violations relate to captive reinsurance arrangements that the CFPB claims disguised illegal kickbacks.

The *PHH* court ruled that the reinsurance premiums mortgage insurers paid to PHH subsidiaries are legal as long as they did not exceed reasonable market value for the reinsurance. This, in the court's view, assures that the reinsurance premiums do not mask kickbacks that reward PHH for referring mortgage insurance business to insurers that purchase reinsurance from PHH-affiliated companies.

The *PHH* court remanded the RESPA issue to the CFPB for a determination of whether the mortgage insurers in fact paid more than reasonable market value for reinsurance in this case.

The *PHH* court further noted that even if the CFPB's interpretation of the relevant provision of RESPA (Section 8) was consistent with the statute (which the court found it was not), the CFPB violated due process by applying its new interpretation retroactively to PHH's conduct that preceded the CFPB's new interpretation.

The CFPB has petitioned for an en banc review of the *PHH* court's holding regarding the proper interpretation of Section 8 of RESPA and of its due process holding. *See* CFPB Petition at 14-15.

Notably, the CFPB did not ask the full D.C. Circuit to review the *PHH* court's holding that administrative proceedings brought under the Dodd-Frank act are subject to the same statutes of limitations that apply to district court proceedings brought to enforce the same laws.

The *PHH* court interpreted 12 U.S.C. § 5563(a)(2), which authorizes the CFPB to conduct hearings and adjudication proceedings "unless such Federal law specifically limits the Bureau from conducting a hearing or adjudication proceeding" to incorporate statutes of limitations as a limit on the CFPB's enforcement authority. *PHH,* 839 F.3d at 51.

By not seeking en banc review of this holding, the CFPB appears to have conceded this point. However, Section 5563(a)(2), may not apply to all administrative actions brought by the CFPB.[10]

Future proceedings in the *PHH* case and decisions that apply the precedents that ultimately emerge from that case may significantly affect the scope of the Bureau's authority.

Director Corday's and the CFPB's ability to retroactively ratify past actions may prove important

In *Consumer Financial Protection Bureau v. Gordon*, 819 F.3d 1179 (9th Cir. 2016), the Ninth Circuit considered whether Director Cordray's recess appointment on January 4, 2012 — which was made when the Senate was in a pro-forma session — rendered the Bureau's action against Gordon invalid.

The court assumed that Corday's recess appointment violated the Appointments Clause of the Constitution, but found that this neither deprived the CFPB of standing to litigate the case nor rendered the enforcement action against Gordon unconstitutional.

On the first point, the Ninth Circuit made it clear that any issue with Cordray's appointment did not raise an Article III standing issue because the Executive Branch's interest in enforcing federal law was independent of Cordray's.

The court further held that even if Cordray's recess appointment was invalid, "Cordray's August 2013 ratification, done after he was properly appointed as director, resolves any appointments clause deficiencies."[11] *Id.* at 1192.

The Ninth Circuit denied Gordon's petition for rehearing en banc on July 20, 2016, and he subsequently filed a petition for writ of certiorari with the U.S. Supreme Court.

The certiorari petition asks the Court to decide whether:

- A federal official can retroactively ratify an ultra vires government action when (1) no federal official was authorized to perform the act at the time it was initially undertaken, (2) the purported ratification does not include an examination of any facts related to the act performed, and (3) the ratification purports to encompass not only the initial act but also federal court rulings entered in response to the act.
- Whether federal courts possess Article III subject matter jurisdiction to hear a case filed at the behest of an individual who, from the time suit was filed until judgment was entered, lacked authority to vindicate the Executives Branch's interest in seeing that the law is obeyed.

See Petition for Writ of Certiorari, *Gordon v. Consumer Fin. Prot. Bureau,* No. 16-673 (U.S. Nov. 17, 2016).

The certiorari petition claims that the Ninth Circuit's *Gordon* opinion conflicts with Supreme Court precedent and with other circuit court decisions and asserts that the recent *PHH* decision underscores the need for the Court to clarify the scope of an agency's ratification power.

In *PHH,* the D.C. Circuit ruled that the CFPB's single-director-removable-only-for-cause structure is unconstitutional but noted that it "need not here consider the legal ramifications of our decision for past CFPB rules or for past agency enforcement actions." *See PHH*, 839 F.3d at 39, n.19.

The *PHH* court thus declined to consider whether CFPB actions taken between January 2012 and October 2016 (when the Court held that the CFPB was unconstitutionally structured) are still valid.

Many anticipate that the CFPB may move to retroactively ratify those actions raising questions about ratification similar to those presented in *Gordon*.

If the *PHH* decision stands, the CFPB's authority to ratify actions taken prior to that decision may affect the extent to which the decision disrupts existing Bureau rules and administrative decisions.

We will therefore be carefully watching to see if the U.S. Supreme Court agrees to review *Gordon*, or if courts rely on the Ninth Circuit's *Gordon* opinion to recognize that ratification may insulate the Bureau's past actions from constitutional challenges.

On one occasion, the federal district court in the District of Columbia has already relied in part on *Gordon* to grant summary judgment to the CFPB in the face of a challenge to rules promulgated by the CFPB prior to Director Cordray's Senate confirmation. In *State National Bank of Big Spring v. Lew*, No. CV 12-1032 (ESH), 2016 WL 3812637 (D.D.C. July 12, 2016), the court explained that a violation of the Appointments Clause creates prejudice only where it likely affected the agency's decision because a properly appointed decision-maker might have taken a different approach. *Id.* at *6.

> The dramatic drop in CFPB complaints filed against mortgage industry actors does not reflect a lack of CFPB scrutiny of the industry.

The court further explained that where, as here, the very same decision-maker ratifies his own challenged decisions, "any chance of prejudice is effectively wiped out." *Id.*

CFPB's civil investigative demand authority is not limitless

A federal district court recently held that the CFPB's authority to issue a civil investigative demand (CID) *did not* extend to the accreditation processes for a for-profit school.

In *Consumer Financial Protection Bureau v. Accrediting Council for Independent Colleges & Schools*, No. CV 15-1838 (RJL), 2016 WL 1625084 (D.D.C. Apr. 21, 2016), the court explained that the CFPB's authority to issue CIDs was limited to inquiries to determine whether there has been a violation of consumer financial laws.

The court then held that the CFPB exceeded this authority when it issued a CID to an accrediting body with the stated purpose of "determin[ing] whether any entity or person has engaged or is engaging in unlawful acts and practices in connection with accrediting for-profit colleges." *Id.* at *1.

The CFPB argued that because it has authority to investigate for-profit schools in relation to their lending and financial-advisory services, it also has authority to investigate if there are unlawful acts occurring in relation to the accreditation of these schools.

The court rejected this argument, explaining that "[a]lthough it is understandable that new agencies like the CFPB will struggle to establish the exact parameters of their authority, they must be especially prudent before choosing to plow headlong into fields not clearly ceded to them by Congress."

This ruling came amidst allegations that the accreditor had been too lax in approving for-profit colleges, some of which have been accused of misleading students about job placement rates, using manipulative recruitment schemes, and employing unfair lending practices.

The CFPB filed a notice of appeal with the D.C. Circuit Court of Appeals in June 2016. But, if the ruling stands, it may make it more challenging for the Bureau to conduct broad, wide-ranging investigations using its compulsory investigative authorities, and it may make it more likely that CID recipients and defendants will be more willing to challenge the CFPB.

True lender analysis dictates which state laws regulate loans and violations of those state laws may form the foundation of a "deceptive act"

In contrast to the series of decisions discussed above that have the potential to fence in the CFPB's authority, a federal court in California handed the Bureau a win that may help expand the CFPB's reach.

In *Consumer Financial Protection Bureau v. CashCall Inc., No.* CV15-7522-JFW, 2016 WL 4820635 (C.D. Cal. Aug. 31, 2016), the court held that CashCall, based in Orange County, California, was the true lender of loans made by a tribal lending entity, Western Sky Financial.

In the arrangement scrutinized by the court, CashCall marketed, processed, and eventually bought and serviced the loans despite the fact that the loan documents identified Western Sky Financial, an entity associated with the Cheyenne River Sioux Tribe, as the lender.

CashCall asserted that because Western Sky was the lender, tribal laws preempted state licensing statutes and usury limits.

The court conducted a fact-intensive examination to determine that CashCall had the "predominant economic interest" in the loans and therefore was the "true lender." As a result, the loans were not exempt from state regulations. *Id.* at *5-6.

Having so established, the court conducted a choice of law analysis and determined that the state law of the borrowers' home states was the appropriate law to apply to the loans at issue.

The maximum usury limits of all the implicated state laws prohibited the loans at issue, which charged interest rates greater than 80%. Thus, the court concluded that CashCall had deceived consumers by creating the false impression that the loans were enforceable.

> Although the CFPB initiated fewer new enforcement actions across all industries in 2016, its lawyers and other staff members appear to be busy.

The court recently granted CashCall's request for interlocutory appeal. If the opinion stands, it may also embolden the CFPB to explore other ways in which it can point to state law violations as a foundation for enforcement actions alleging unfair, deceptive, or abusive acts and practices.

In addition, the fact-specific "true lender" test applied by the *CashCall* court could affect what laws apply to loans solicited by marketplace lenders. Internet-based marketplace lenders often solicit consumers across the country for loans extended by a partner bank.

By partnering with a bank, marketplace lenders have thought they can legally bypass many state licensing requirements and usury restrictions. This is because banks are regulated by federal laws that preempt many state rules.

Those laws allow banks to charge interest rates that comply with the laws of the jurisdiction in which the depository institution is located rather than where the borrower resides.

If the non-bank marketplace lender is the "true lender" in such arrangements, the loans they service may well be subject to the variable laws of the states in which the borrowers reside.

Marketplace lenders are also watching to see if the CFPB will issue rules that will subject larger marketplace lenders to the Bureau's onsite supervisory examinations.

The Bureau's Fall 2015 regulatory agenda[12] included plans to develop rules to define larger participants in the markets for consumer installment and vehicle title loans. Its March 2016 announcement that it had begun accepting consumer complaints about online marketplace lenders led many to believe that the Bureau will craft these rules to reach marketplace lenders.

The CFPB faces political challenges

The CFPB is not only facing legal challenges, but is no doubt also bracing for political challenges to its authority in 2017.

Many Congressional Republicans have made it clear that they would like to curtail the CFPB's independence by replacing its director with a multi-member commission, subjecting it to the congressional appropriations process, and imposing a series of other checks on its authority; others have urged President Trump to rely on the *PHH* decision to fire Director Cordray without waiting for appeals of that decision to be heard; still others have proposed outright abolition of the agency.

President Trump's personal views on the Bureau are unknown, but he has publicly criticized Senator Elizabeth Warren who was instrumental in the Bureau's creation.

Created in the wake of the financial crisis in 2011, the Bureau commenced most of its responsibilities on July 21, 2011, the "designated transfer date" on which it assumed oversight of consumer compliance rules from seven different federal agencies.

Extensive controversy surrounding the appointment of a director has raised questions about the parameters of the Bureau's authority at various times. This past year, some of those challenges — and other challenges to the CFPB's authority — began to make their way through the court system. But further *political* changes could very well be on the horizon for 2017, regardless of the ultimate resolution of the *PHH* case and others discussed above.

CONCLUSION

There is no denying a possibility that legislative changes could curtail the CFPB's authority in the coming year and that a new Director will eventually be appointed by President Trump.

If the *PHH* court decision stands, Trump may replace Director Cordray before his term expires in mid-2018. However, if the CFPB succeeds in reversing that decision, Director Cordray may serve out his term.

Although the future is unclear, it seems the CFPB is unlikely to be subject to a wholesale dismantling any time soon. Thus, entities subject to the CFPB's enforcement and supervisory authority should be carefully watching for appellate court action on many of the decisions discussed above and monitoring how the CFPB modifies its practices in light of these decisions. WJ

NOTES

[1] These figures exclude actions against individuals that were filed in conjunction with a corporate action.

[2] Rachel Witkowski, *Backlog Forces CFPB to Slow Down New Investigations*, American Banker, April 22, 2015, http://www.americanbanker.com/news/law-regulation/backlog-forces-cfpb-to-slow-down-new-investigations-1073951-1.html.

[3] *Id.*

[4] CFPB Supervisory Highlights: Fall 2016, October 31, 2016, http://files.consumerfinance.gov/f/documents/Supervisory_Highlights_Issue_13__Final_10.31.16.pdf at 31.

[5] *Id.* at 28-29 (noting that the factors are described in detail in an Interagency Fair Lending Examination Procedures).

[6] Amendments to Federal Mortgage Disclosure Requirements Under the Truth in Lending Act (Regulation Z), 81 FR 54317 (Aug. 15, 2016) (to be codified at 12 CFR 1026).

[7] Amendments to the 2013 Mortgage Rules Under the Real Estate Settlement Procedures Act (Regulation X) and the Truth in Lending Act (Regulation Z), 81 FR 721601-01 (Oct. 19, 2016) (to be codified at 12 CFR 1024, 1026).

[8] CFPB Supervisory Highlights Mortgage Servicing Edition, June 2016, https://s3.amazonaws.com/files.consumerfinance.gov/f/documents/Mortgage_Servicing_Supervisory_Highlights_11_Final_web_.pdf.

[9] *See* CFPB Supervisory Highlights: Fall 2016, October 31, 2016, http://files.consumerfinance.gov/f/documents/Supervisory_Highlights_Issue_13__Final_10.31.16.pdf; CFPB Supervisory Highlights: Summer 2016, June 30, 2016, http://www.consumerfinance.gov/data-research/research-reports/supervisory-highlights-issue-no-12-summer-2016/; CFPB, Supervisory Highlights: Winter 2016, March 8, 2016, http://files.consumerfinance.gov/f/201603_cfpb_supervisory-highlights.pdf.

[10] For instance, administrative proceedings alleging Unfair, Deceptive or Abusive Acts or Practices, (UDAAPs), which arise from the Dodd-Frank Act itself are subject to a separate three-year statute of limitations established in Section 5564(g)(1) of the Dodd-Frank Act. The CFPB has argued that Section 5564(g)(1) applies only to civil actions and the *PHH* court did not reach this question. Thus, the CFPB may continue to take the position that no statute of limitation applies to administrative proceedings brought solely under its UDAAP authority.

[11] On July 13, 2013, Cordray was confirmed by the Senate by a 66 to 34 vote.

[12] Kelly Cochran, "Fall 2015 Rulemaking Agenda," *CFPB Blog* (Nov. 20, 2015), available at http://www.consumerfinance.gov/about-us/blog/fall-2015-rulemaking-agenda/.

Morgan Stanley can't shake $32 million CDO suit

By Peter H. Hamner Esq.

Morgan Stanley & Co. and Countrywide Financial Corp. subsidiaries must face a 2014 lawsuit alleging they marketed a collateralized debt obligation knowing it would fail, costing an investment fund $32 million.

Loreley Financing (Jersey) No. 3 Ltd. et al. v. Morgan Stanley & Co. et al., Nos. 2874 and 1874A, 2017 WL 366349 (N.Y. App. Div., 1st Dep't Jan. 26, 2017).

The New York Supreme Court's 1st Department Appellate Division upheld a trial judge's 2016 decision allowing Loreley Financing (Jersey) No. 3 Ltd. to go forward with fraud claims against Morgan Stanley and Countrywide.

New York County Supreme Court Justice Jeffrey K. Oing ruled that Loreley's suit adequately alleges the banks knew the securities underlying the CDO were bad. The judge did dismiss the plaintiff's claims of rescission, fraudulent conveyance and unjust enrichment. *Loreley Fin. (Jersey) No. 3 Ltd. et al. v. Morgan Stanley & Co. et al.*, No. 651633/2014, 2016 WL 4063057 (N.Y. Sup. Ct., N.Y. Cty. July 26, 2016).

THE ALPHA MEZZ CDO

The case concerns a CDO called Alpha Mezz CDO 2007-1 LTD that Morgan Stanley and Countrywide subsidiaries structured, issued and marketed. The defendants filled the CDO with residential mortgage-backed securities — financial instruments tied to payments from underlying mortgage loans.

Loreley allegedly invested $32 million in notes issued by the Alpha Mezz CDO in February 2007 based on the defendants' representations regarding the underlying loan quality.

According to Justice Oing's opinion, the CDO failed and credit raters downgraded the notes to "junk status" in July 2008, rendering Loreley's investment worthless.

Loreley's complaint alleges the defendants knew the mortgage-backed securities did not meet the represented underwriting quality.

According to the suit, the defendants obtained a large number of the mortgages from now-defunct subprime lender New Century Financial Corp. They allegedly knew the loans were prone to default because the banks had served as New Century's warehouse lender and loan securitizer.

Morgan Stanley and Countrywide also allegedly hired Clayton Holdings Inc., which performed a "due diligence" review of the loans and found them deficient.

FRAUD CLAIM SURVIVES

The defendants filed a dismissal motion, which Justice Oing granted in part and denied in part.

The judge let the plaintiff's fraud claim proceed, holding that the suit properly pleads that the banks knew the CDO was risky and marketed it despite Loreley's request for a safe investment.

Justice Oing rejected the defendants' argument that they warned Loreley about the risks associated with the CDO. The disclosures were general and did not warn that the underlying mortgages did not meet the represented underwriting guidelines, the judge said.

JUSTIFIABLE RELIANCE

In affirming the decision, the Appellate Division rejected the defendants' claim that Loreley cannot establish "justifiable reliance" on the CDO's marketing materials because the fund was warned about the CDO's risks but failed to inquire into the disclosed risks.

A plaintiff is required to investigate an alleged misrepresentation only if there were hints of falsity, the appeals panel said.

As alleged, the CDO's marketing materials did not give hints of falsity and therefore Loreley can claim justifiable reliance, it said. WJ

Related Filing:
Opinion: 2017 WL 366349

No coverage under failed bank's D&O policy, 9th Circuit says

Security Pacific Bank's D&O insurance policy excluded coverage for former directors and officers who reached a settlement with a federal regulator seeking compensation for the failed bank's shareholders, a divided 9th Circuit appeals panel has ruled.

Federal Deposit Insurance Corp. v. BancInsure Inc., No. 14-561323, 2017 WL 83489 (9th Cir. Jan. 10, 2017).

In another recent opinion in a series of closely watched director and officer insurance coverage cases involving banks that failed amid the 2008 subprime mortgage-related financial crisis, the 9th U.S. Circuit Court of Appeals panel ruled 2-1 that an "insured vs. insured" exclusion in a policy issued by BancInsure Inc. unambiguously excluded coverage for regulatory actions.

Courts have split over the interpretation of a common D&O policy exclusion that bars coverage for any suit brought by one insured entity, such as the firm or its successor, against another "insured," such as a director or officer.

Some courts have found that when the Federal Deposit Insurance Corp. takes over as receiver of a failed bank, it always steps into the bank's shoes and is an "insured" as a successor under the policy. Others have found that the "insured" designation depends on what role the government is playing, making the insured-vs.-insured clause ambiguous.

MAKING A DIFFERENCE

Kevin M. LaCroix, an insurance law specialist who edits the D&O Diary blog, said in a Jan. 11 post that, unlike many other D&O policies, SPB's insured-vs.-insured clause "contained language specifically precluding coverage for claims brought by a 'receiver,'" which "clearly makes an analytic difference."

"In the absence of this language, the consensus seems to be that the exclusion's applicability to FDIC-R claims is ambiguous," he said, referring to opinions in cases where the agency is acting as receiver for the bank.

In the SPB situation, the FDIC had prepared to sue the Los Angeles-based bank's former directors and officers in 2011 for negligence, gross negligence and breach of fiduciary duty in an attempt to recover about $60 million for investors.

Before filing the suit, the FDIC reached a settlement in which the would-be defendants assigned their rights under the BancInsure policy to the agency.

BancInsure refused to provide coverage for the alleged losses, citing the insured-vs.-insured exclusion. The FDIC then sued in the U.S. District Court for the Central District of California, seeking a declaratory judgment that the exclusion did not apply because of the agency's "unique role."

A regulatory exclusion is a common D&O insurance clause in bank policies.

The FDIC argued that the signers of the policy must have intended to allow coverage for government actions. Alternatively, it argued that the elimination of the regulatory exclusion means, at the very least, that the insured-vs.-insured language barring coverage renders the policy ambiguous.

> The bank's insured-vs.-insured clause "contained language specifically precluding coverage for claims brought by a 'receiver,'" which "clearly makes an analytic difference," insurance law specialist Kevin LaCroix said.

The FDIC pointed to an exception for suits involving derivative claims by investors, who are not "insureds" under the policy, and argued that the settled D&O claims related to shareholder interests and not to the agency's interest as receiver.

In a 2014 order U.S. District Judge Dolly M. Gee agreed with the FDIC and granted its declaratory judgment motion. BancInsure appealed, and the 9th Circuit panel reversed.

IN THE DIRECTORS' SHOES?

The panel's majority noted that a shareholder derivative action can be brought only if a company's directors have failed utterly in their duty to pursue a remedy for alleged wrongdoing. In this case, the FDIC, as designated successor to SPB and its directors, had a priority obligation to step in and sue in the name of the company and the board.

Because the FDIC had fulfilled that obligation, there was no void for a shareholder representative of any kind to fill, and the regulator was acting as a successor, which is an "insured" under the policy, the majority said.

The FDIC also pointed to a policy endorsement that eliminated a regulatory exclusion that would have barred coverage for any action by government agencies.

But the majority found that the elimination of the regulatory exclusion did not "vary, waive, or extend any of the other terms of the D&O policy and thus did not alter the scope of the insured-vs.-insured exclusion."

The panel remanded the case to the lower court with instructions to enter judgment in favor of BancInsure.

THE DISSENT

In a dissenting opinion, U.S. Circuit Judge Johnnie B. Rawlinson noted that the SPB endorsement went so far as to delete the regulatory exclusion entirely, indicating that the signers intended to allow coverage.

At the very least, she said, the deletion creates ambiguity because it makes two interpretations of the policy equally viable.

"Coverage is particularly mandated when one keeps in mind that California courts construe coverage broadly, exclusions narrowly and place the burden on insurers to 'phrase … exclusions in clear and unmistakable language,'" she said, quoting the California Supreme Court's opinion in *MacKinnon v. Truck Insurance Exchange*, 31 Cal. 4th 635 (2003).

"The District Court got it right," she said. WJ

Related Filing:
Memorandum opinion: 2017 WL 83489

FAIR CREDIT REPORTING ACT

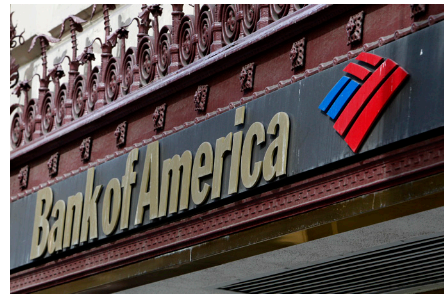
Woman says bank illegally reported expired debt to credit agencies

A bank violated federal law by reporting an expired debt as owing on a woman's credit reports, a Florida federal lawsuit claims.

Sanchez v. Bank of America Corp., No. 17-cv-60276, complaint filed (S.D. Fla. Feb. 3, 2017).

Maria Sanchez of Hallandale Beach, Florida, says Bank of America is disseminating inaccurate credit information about her in violation of the Fair Credit Reporting Act.

The FCRA, 15 U.S.C.A. § 1681, requires credit reporting agencies and the businesses that provide them with consumer debt information to take reasonable steps to ensure the data is accurate.



REUTERS/Fred Prouser

The plaintiff says Bank of America is disseminating inaccurate credit information about her in violation of the Fair Credit Reporting Act.

OBSOLETE DEBT

In a complaint filed in the U.S. District Court for the Southern District of Florida, Sanchez says she first went into default on an account with BofA in April 2009.

The bank, however, notified non-party credit reporting agencies Equifax Information Services Inc., Experian Information Services Inc. and TransUnion LLC that the first date of delinquency on the account was August 2011, according to the suit.

By listing a more recent default date the bank has revived an obsolete debt in violation of the FCRA, Sanchez says. Under Section 1681c of the statute credit reporting companies cannot obtain or disseminate information on accounts more than seven years old.

The suit says that as a result of BofA's erroneous information, the credit agencies are disseminating inaccurate reports on the plaintiff.

DISPUTES RAISED

Sanchez alleges that in June and July 2016 she notified Equifax, Experian and TransUnion that she disputed the debt. She also gave the credit companies documentation supporting the debt's inaccuracy, according to the complaint.

Each of the credit agencies contacted BofA about the disputed debt but the bank did not investigate the matter or remove the obsolete information from Sanchez's credit files, the complaint says.

BofA committed additional violations of the FCRA by willfully and negligently failing to investigate the disputes, by failing to review all relevant information about the account and by continuing to report inaccurate credit information to the credit agencies, Sanchez alleges.

She says she has incurred expenses to dispute the debt and suffers emotional distress over being associated with derogatory credit information. She also says the inaccurate data is impacting her ability to obtain credit.

The suit seeks statutory damages of $1,000, unspecified compensatory and punitive damages and attorney fees and costs. WJ

Attorney:
Plaintiff: David M. Marco, Smith Marco PC, Chicago, IL

Related Filing:
Complaint: 2017 WL 489335

See Document Section B (P. 28) for the complaint.

Judge OKs bank title claim in suit over lien holder's home foreclosure

Bank of America can proceed with efforts to establish a priority interest in a mortgaged property that a homeowners association foreclosed upon and sold after the owners failed to pay a $1,000 assessment, a Nevada federal judge has ruled.

Bank of America N.A. v. Antelope Homeowners' Association et al., No. 16-cv-449, 2017 WL 421652 (D. Nev. Jan. 30, 2017).

U.S. District Judge James C. Mahan of the District of Nevada refused to dismiss the bank's quiet title claim over a Las Vegas property that the Antelope Homeowners' Association sold following foreclosure on an assessment lien.

Nevada law permits a person or entity who claims to hold a superior interest in real property can bring a quiet title action against those holding competing interests, Nev. Rev. Stat. § 40.010. To prevail on such a claim, the plaintiff must show that its claim to the property is superior to that of all others, the judge's opinion said.

Judge Mahan, however, dismissed as untimely the bank's causes of action against Antelope and its agent Alessi & Koenig LLC for wrongful foreclosure and breach of a state statutory obligation to act in good faith.

THE LIEN

According to the opinion, non-parties Tony Barrios, Justo Barrios and Kristina Barrios took out a $214,621 mortgage in July 2008 from Universal American Mortgage Co. The Federal Housing Administration insures the underlying note and deed of trust.

After the homeowners failed to pay Antelope a $1,000 assessment Alessi placed a lien against the property in June 2009. Alessi, acting pursuant to state law that allows for non-judicial foreclosure by homeowners associations, held a foreclosure sale and in March 2011 Las Vegas Development Group LLC bought the property for $4,666, according to the opinion.

A SUPERIOR INTEREST

BofA, which had acquired the deed of trust at some point prior to the foreclosure, sued Antelope, Alessi and LVDG in the District Court in March 2016 alleging breach of good faith under the state's property rights law and wrongful foreclosure.

The bank sought declaratory judgment on its quiet title, arguing that its deed of trust securing a loan with a $210,000 balance was the superior lien on the property and not extinguished by the foreclosure.

Antelope sought dismissal of the quiet title claim saying BofA had failed to state a claim, that the claims was untimely and that the bank had failed to pursue mediation of the dispute.

The homeowners' association further argued that the wrongful foreclosure and breach of the duty of good faith claims were time barred, according to the opinion.

QUIET TITLE CLAIM

Judge Mahan rejected the defendant's argument, noting that Nev. Rev. Stat. § 11.070 includes a five-year limitations period for quiet title claims.

The quiet title claim was timely, the judge ruled, since the foreclosure sale occurred March 2, 2011, and the bank filed the suit March 2, 2016. He also said the claim is not subject to mediation.

Under Nev. Rev. Stat. § 38.310, actions over residential property covenants or homeowners association's bylaws and regulations are required to go to mediation before a civil action can be filed, according to the opinion.

A quiet title claim, however, seeks a determination of which party has the superior title to land and is not the type of civil action that must go through mediation, Judge Mahan said.

He also rejected Antelope's argument that the bank failed to state a claim for quiet title, noting that BofA claims the Supremacy Clause of the U.S. Constitution prevents the foreclosure sale from extinguishing its senior deed of trust because the Federal Housing Administration insures the deed.

Foreclosure on federal property is prohibited where it interferes with the statutory mission of a federal agency, the opinion said.

If a homeowners' association's foreclosure can "wipe out" the deed of trust on a federally-insured property the FHA insurance program will be subject to interference, Judge Mahan said.

UNTIMELY CLAIMS

The judge dismissed the bank's claims regarding the alleged breach of the duty of good faith and wrongful foreclosure as untimely.

Under Nevada law, a claim for damages based on the alleged breach of a statutory duty must be brought within three years, but BofA filed its suit five years after the March 2011 foreclosure sale, the opinion said.

The wrongful foreclosure claim is likewise time barred because it sought damages based on a state statute and was not brought within three years, Judge Mahan ruled. WJ

Related Filing:
Opinion: 2017 WL 421652

See Document Section C (P. 32) for the opinion.

Bank gets no coverage for $24 million settlement over overdraft fees

By Thomas Parry

BancorpSouth Inc. cannot get coverage for a $24 million settlement of a class action over overdraft fees because of an exclusion for fee-based claims in its professional liability insurance policy, an Indiana federal judge has ruled.

BancorpSouth Inc. v. Federal Insurance Co., No. 16-cv-1871, 2017 WL 373300 (S.D. Ind. Jan. 26, 2017).

In tossing Bancorp's lawsuit against Federal Insurance Co., U.S. District Judge Sarah Evans Barker of the Southern District of Indiana rejected the bank's characterization of the settlement as arising from its policies rather than its fees.

"It was [Bancorp's] assessment of the overdraft fees that caused the [class action] plaintiffs harm, and the relief they successfully achieved came in the form of a return of those fees," Judge Barker wrote in a Jan. 26 order.

The judge also found that broad applicability of the policy exclusion's coverage bar did not render it ambiguous.

CLASS ACTION TARGETS 'UNCONSCIONABLE' FEES

Bancorp customer Shane Swift filed a class-action lawsuit in a Florida federal court in 2010, alleging the bank unfairly assessed excessive overdraft fees. The complaint asserted claims for conversion and breach of contract.

Swift's suit said Bancorp used various schemes to maximize these charges, including the arrangement of debits from

highest to lowest and providing customers with inaccurate balances.

Bancorp settled the class action for $24 million in February 2016, the order said.

The bank sought coverage under its professional liability policy with Federal, but the insurer refused, citing an exclusion for "loss on account of any claim … arising from … any fees."

Bancorp filed a declaratory judgment action against Federal in the Southern District of Indiana, asserting the insurer had breached its policy in bad faith.

EXCLUSION OF FEE-BASED CLAIMS

Judge Barker granted Federal's motion to dismiss, finding that the exclusion of fee-based claims applied to the Swift class action.

Bancorp argued that the Swift suit did not fall within the exclusion because it asserted damage caused by the bank's policies, such as the practice of failing to inform customers of negative account balances.

The judge disagreed, finding that the practices described in the suit were geared to generate the allegedly excessive overdraft charges.

Describing Bancorp's policies "did not transform the Swift lawsuit into a dispute over anything other than 'fees,'" she wrote.

Bancorp argued the exclusion was ambiguous and created illusory coverage because it did not specify whether it applied to fees the bank levied or owed.

The exclusion clearly applied to both types of fees, Judge Barker explained, finding that Bancorp's argument confused breadth with ambiguity.

Furthermore, the exclusion did not render Bancorp's coverage illusory, she said.

"For example, claims involving the quality of a service (which was provided for a fee) would not be subject to the exclusion for loss related to fees," the judge wrote. WJ

Related Filing:
Opinion: 2017 WL 373300

See Document Section D (P. 37) for the complaint.

Judge sets bar too high for antitrust claims against JPMorgan, 2nd Circuit says

A 2nd Circuit appeals panel has revived antitrust litigation over JPMorgan Chase & Co.'s trading of silver futures, saying a trial judge wrongly required more detail than necessary for the lawsuits to go forward.

Wacker v. JPMorgan Chase & Co. et al., Nos. 16-2482, 16-2484 and 16-2530, 2017 WL 442366 (2d Cir. Feb. 2, 2017).

The 2nd U.S. Circuit Court of Appeals said in a Feb. 1 ruling that U.S. District Judge Paul A. Engelmayer of the Southern District of New York imposed too high a pleading standard on suits filed in 2015 by three silver futures traders.

Judge Engelmayer ruled in January 2016 that the traders had failed to adequately plead monopolization under Section 2 of the Sherman Act, 15 U.S.C.A. § 2, and the New York General Business Law because the suits could not connect the allegedly anti-competitive scheme with specific manipulative trades. *Shak et al. v. JPMorgan Chase & Co. et al.*, Nos. 15-cv-992, 15-cv-994 and 15-cv-995, 2016 WL 154119 (S.D.N.Y. Jan. 12, 2016).

SILVER FUTURES CALENDAR SPREADS

Metals traders Daniel Shak, Thomas Wacker and Mark Grumet sued separately, accusing JPMorgan of using its market power to manipulate the silver futures calendar spreads market in late 2010 and early 2011.

Futures are contracts that allow participants to buy or sell a standard quantity of a financial asset or commodity on a future date at a fixed price.

Silver futures calendar spreads trading consists of buying and selling two futures contracts with varying "delivery dates," or contract expiration dates, with the goal of profiting from the change in price between the two contracts.

In a "long" calendar spread, a trader buys a futures contract with an early delivery date while selling an identical contract with a later delivery month. In a "short" calendar spread, a trader sells a futures contract with an early delivery date while buying a corresponding contract in a later month.

> The plaintiffs only need to "raise a reasonable expectation that discovery will reveal evidence of illegality," the appeals panel said.

JPMORGAN'S ALLEGED CONDUCT

The plaintiff traders say the silver futures market consisted of JPMorgan and a few smaller firms in 2010 and 2011.

As a result of its large market presence, when JPMorgan placed large orders near the close of its contracts to benefit its position, it allegedly caused futures contracts prices to move from "contango" to "backwardation," a rare market condition for futures markets.

Contango is a market condition in which investors are willing to pay more for a commodity at some point in the future than the actual expected price of the commodity.

Backwardation is the opposite condition, when investors are willing to pay less for a commodity at some point in the future than the actual expected price of the commodity.

JPMorgan's actions put pressure on the plaintiffs' positions, and they had to liquidate, taking losses on their trades in early 2011.

DISMISSAL AND APPEAL

JPMorgan moved to dismiss the three suits, and Judge Engelmayer consolidated briefing on the motion.

He dismissed the antitrust allegations as vague and lacking in specifics about particular JPMorgan orders and also said the claims did not demonstrate the existence of an anti-competitive scheme.

He also ruled that the plaintiffs' Commodity Exchange Act claims were untimely because the law's two-year limitations period began to run in early 2011, making the 2015 complaints late.

The traders appealed the dismissal of the antitrust allegations to the 2nd Circuit.

Although the plaintiffs did not provide details on JPMorgan's alleged uneconomic bids, they specified 14 days on which the firm allegedly submitted bid/asks that exceeded silver futures' alleged value. Those allegations were detailed enough to survive a motion to dismiss, the appeals panel ruled.

The plaintiffs need only "'raise a reasonable expectation that discovery will reveal evidence of illegality,'" the panel said, quoting *Mayor of Baltimore v. Citigroup Inc.*, 709 F.3d 129 (2d Cir. 2013). WJ

Related Filing:
Order: 2017 WL 442366

Review of bankruptcy 'safe harbor' for securities transactions is premature, litigation trustee says

By Donna Higgins

There is no split among the circuit courts in their interpretation of a key phrase in a Bankruptcy Code "safe harbor" provision for securities transactions that involve financial institutions, so the U.S. Supreme Court should not step in now, the litigation trustee for a bankrupt racecourse says.

Merit Management Group LP v. FTI Consulting Inc., No. 16-784, opposition brief filed (U.S. Jan. 19, 2017).

Only one federal appeals court has given in-depth attention to the question presented in the petition — and that was the 7th U.S. Circuit Court of Appeals in its decision from which the petitioners are seeking review, FTI Consulting Inc. argues in a Jan. 19 brief opposing review of the ruling.

The petition concerns Section 546(e) of the Bankruptcy Code, 11 U.S.C.A. § 546(e), a safe harbor provision that bars bankruptcy trustees from pursuing fraudulent-conveyance claims to recover payments in connection with securities contracts "made by or to (or for the benefit of)" a financial institution.

The 7th Circuit held that the safe harbor does not apply when a financial institution is merely a conduit for the money. *FTI Consulting v. Merit Mgmt. Group*, 830 F.3d 690 (7th Cir. 2016).

"This case represents the first decided by any circuit court where the interpretation of the statutory language 'by or to (or for the benefit of)' was the sole issue considered and addressed," FTI argues.

The question should be allowed to "percolate back up to the circuit courts" so they can benefit from the 7th Circuit's in-depth analysis, FTI says.

FAILED 'RACINO' VENTURE

According to the 7th Circuit panel's opinion, Valley View Downs LP, a Pennsylvania racetrack owner, reached a deal to buy another racetrack owned by Bedford Downs Management Corp., its competitor for Pennsylvania's last harness-racing license, for $55 million. Valley View borrowed money from Credit Suisse, and Citizens Bank of Pennsylvania was the escrow agent.

Valley View obtained the harness-racing license but was unable to secure a gambling license it needed to operate a "racino," a combined track and casino, the opinion said. Valley View and several related debtors filed for Chapter 11 protection in the U.S. Bankruptcy Court for the District of Delaware in 2009. FTI Consulting Inc. was ultimately named trustee of the debtors' litigation trust.

As trustee, FTI sued Illinois-based Merit, which held a 30 percent interest in Bedford Downs, in the U.S. District Court for the Northern District of Illinois in 2011. The trustee sought to avoid Merit's 30 percent share, or $16.5 million, of the $55 million Valley View paid in the Bedford Downs deal, asserting that the funds were part of Valley View's bankruptcy estate and thus the trust, the panel said.

FTI alleged the transfer was fraudulent and avoidable under Sections 544, 548(a)(1)(B) and 550 of the Bankruptcy Code, 11 U.S.C.A. §§ 544, 548(a)(1)(B) and 550.

Merit countered that the transfer was a "settlement payment" or payment in connection with a securities contract "made by or to (or for the benefit of)" a financial institution listed in a safe harbor provided by Section 546(e). It argued the safe harbor applied because Citizens Bank and Credit Suisse were financial institutions, so the transfer was not subject to avoidance.

The District Court ruled in favor of Merit, and FTI appealed to the 7th Circuit, which reversed, finding that the safe harbor did not apply when a financial institution acted as a conduit for payments that ultimately went to a third party.

MODEST CASES, LARGE IMPORTANCE

"The breadth of the Section 546(e) safe harbor is a recurring and important question," Merit argued. "The courts have struggled with the application of the safe harbor in some of the largest Chapter 11 cases filed during recent economic downturns."

"But the question is equally important in cases of more modest size, in which a claim to unwind an unsuccessful prebankruptcy transaction may be one of the most significant assets of a bankruptcy estate," Merit said.

FTI counters that while other courts have touched on the "made by or to (or for the benefit of)" language in their decisions, those rulings do not show a "deep divide" over how to interpret that phrase.

"Accordingly, the circuit courts should be given the opportunity to consider and, where appropriate, revisit en banc the meaning of the phrase 'by or to' in light of the 7th Circuit's detailed opinion," FTI says. WJ

Attorneys:

Respondent: Barbara W. Balliette, William T. Reid IV, Gregory S. Schwegmann and Joshua J. Bruckerhoff, Reid Collins & Tsai, Austin, TX

Petitioner: Jason J. DeJonker, Leslie A. Bayles and Justin A. Morgan, Bryan Cave LLP, Chicago, IL; Brian C. Walsh and John J. Schoemehl, Bryan Cave LLP, St. Louis, MO

Related Filings:

Opposition brief: 2017 WL 360481
Petition: 2016 WL 7385055

Mortgage servicer harassing man with robocalls, suit says

A mortgage loan servicer continues to make illegal automated debt collection calls to a man's cellphone even though he told the company to stop contacting him, a Tennessee federal court lawsuit says.

Jackson v. Ocwen Loan Servicing LLC, No. 17-cv-2074, complaint filed (W.D. Tenn. Feb. 2, 2017).

Eddie Jackson alleges Ocwen Loan Servicing LLC has phoned him 100 times since he revoked consent to be called, with some calls coming in four times a day.

Jackson, of Shelby County, Tennessee, says Ocwen is willfully and knowingly violating the Telephone Consumer Protection Act, 47 U.S.C.A. § 227, which prohibits the use of automated dialing systems or an artificial or prerecorded voice to call a telephone without the recipient's prior consent.

ROBOCALLS

In a complaint filed in the U.S. District Court for the Western District of Tennessee, Jackson says Ocwen began "bombarding" his cellphone with calls in September 2015 to collect on a mortgage loan.

The company made the calls using an automated dialing system that stores or produces numbers to be called with a random or sequential number generator, such as a predictive dialer, according to the suit. A predictive dialer automatically calls telephone numbers and screens out busy signals, answering machines and disconnected numbers, maximizing the chance a person will answer.

He alleges he knows Ocwen used an autodialer because he received so many calls and because he always heard a pause before a voice came on the line.

The company also made calls with an artificial or prerecorded voice, Jackson says.

CALLS MUST STOP

Jackson says he revoked consent to be called in September 2015 when he told an Ocwen representative to stop phoning him because he had sent in his payment that month and was not late on his loan.

Despite his demand Ocwen continued to make calls multiple times a day and at least 100 times since September 2015, the complaint alleges.

The company has a policy to use autodialers and prerecorded or artificial voices to call consumers without giving them a way to stop the calls, Jackson says.

NUISANCE AND ANNOYANCE

He alleges every call the company made after he revoked consent constituted an injury in the form of a nuisance and an annoyance. He says he had to take time to answer calls or unlock his cellphone and review stored logs for each unanswered call.

Ocwen's calls also expended his phone's battery power and the company's messages took up space on his phone and its network, the suit says.

In addition, Jackson claims his phone's usefulness was impaired while he was dealing with the company's calls and messages and he further alleges his privacy has been invaded.

The suit is seeking an award of unspecified damages and an order preventing Ocwen from continued TCPA violations. WJ

Attorneys:
Plaintiff: Mark Lambert, Morgan & Morgan, Memphis, TN; Amy Ferrera, Morgan & Morgan, Tampa, FL

Related Filing:
Complaint: 2017 WL 490698

Army health care agency must improve debt collection, report says

The U.S. Army Medical Command's improper management of its debt collection efforts has caused it to miss chances to collect a total of $1.8 million from nine delinquent health care accounts, according to auditors.

MEDCOM, which provides health services to active-duty service members, military retirees and their respective family members, may also be losing opportunities to collect more than $38.4 million in debts associated with 21,722 additional delinquent accounts, a Jan. 27 audit report by the Defense Department Office of Inspector General said.

The Army health care agency lacks procedures to process and review accounts that have been marked as past due by medical service providers and has failed to follow rules on the cancellation of collection activity on uncollectible debts, the report said.

BROOKE ARMY MEDICAL CENTER

The OIG conducted the audit between March 2016 and January 2017 to determine whether MEDCOM effectively manages delinquent medical service accounts.

According to the report, federal investigators started with 21,742 medical service accounts worth $41.1 million that various military treatment facilities had flagged as uncollectible and turned over to MEDCOM between June 12, 2012, and March 3, 2016.

The auditors found that the Brooke Army Medical Center at Fort Sam Houston in Texas had sent more than 4,000 delinquent accounts worth $34.2 million to MEDCOM — the highest dollar amount of the accounts deemed uncollectible.

OIG used a sample of Brooke's accounts for the audit and focused on 20 past due accounts worth $2.7 million, according to the report.

Looking at these 20 accounts, the reviewers found that MEDCOM improperly allowed Brooke to stop collecting on 10 accounts worth $1.9 million even though the accounts did not meet government criteria for the termination of collection activity.

Auditors also found that Brooke did not exhaust all collection efforts for nine of these 10 accounts before declaring them uncollectible. MEDCOM did not send the nine accounts back to Brooke for continued debt collection work and therefore missed out on the chance to bring in $1.8 million, the audit concluded.

PROCEDURES LACKING

The OIG concluded that MEDCOM had so many uncollectible medical service accounts on its books because the agency did not have adequate procedures to review submitted delinquent accounts or send them back to the treatment facilities for more collection efforts.

MEDCOM's existing guidance on accounts receivables did not include procedures on how to comply with government rules for the termination of collection efforts, auditors said. For example, collection actions

REUTERS/Kacper Pempel

on debts over $100,000 can only be terminated by the U.S. Justice Department or Treasury Department, the report explained.

The lack of proper procedures caused MEDCOM to miss out on collecting the nine Brooke accounts worth $1.8 million. Unless the agency checks over the remaining 21,722 delinquent accounts, it may lose the chance to collect up to $38.4 million in funds, investigators warned.

SUGGESTED FIXES

The OIG said that based on the audit findings, MEDCOM should review the remaining past-due accounts to make sure treatment facilities exhausted collection efforts.

The agency should also set up procedures, including requiring supporting documentation, so debts marked as uncollectible by treatment facilities can be reviewed and, if necessary, canceled in accordance with government rules.

The OIG noted that MEDCOM has agreed to update policies and guidance in response to the audit. The agency, however, did not agree to conduct a review of the remaining 21,722 accounts, reasoning that the errors identified at Brooke did not warrant review of so many accounts, the report said.

The OIG said it has asked MEDCOM to provide additional information on plans to resolve the suggestions and will continue to monitor the agency's implementation of the recommendations.

The report is available at http://www.dodig.mil/pubs/documents/DODIG-2017-045.pdf. WJ

IRS

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They said the BSA prohibits the imposition of an FBAR penalty if the violation was due to reasonable cause. The Kenteras said they had reasonable cause because the accountants caused the filing error. They alleged the government denied them due process when it did not take this defense into account.

The couple also said that since the IRS disregarded their reasonable cause defense its assessment of penalties violated the APA, which prohibits arbitrary and capricious agency decisions.

They asked the District Court to declare the penalties void.

The government moved to dismiss the suit, saying it did not waive its sovereign immunity with respect to the claims.

THE APA AND THE TUCKER ACT

Judge Stadtmueller said the APA waives governmental sovereign immunity when a plaintiff's claims meet two requirements. First, the suit must seek relief other than money damages and state a claim that an agency acted, or failed to act, in an official capacity.

Second, the plaintiff must show that a substantive statute authorizes review of the agency action, or that review is sought for a final agency action for which there is no other adequate court remedy, he said.

Here, the government asserted that the plaintiffs have an adequate court remedy outside the instant suit because they can pay the penalties and then seek a refund in the U.S. Court of Federal Claims under the Tucker Act, 28 U.S.C. § 1491, Judge Stadtmueller said.

The Tucker Act confers jurisdiction in the Claims Court but it does not create substantive rights, according to the judge. Therefore, to sue in the Claims Court the plaintiffs need a source of substantive law that gives them a damages remedy, he said.

Although the BSA does not expressly give a taxpayer a remedy for an improper FBAR penalty, monetary relief under the statute is implied, he ruled. The statute authorizes the IRS to impose penalties for failure to file an FBAR unless the failure was due to reasonable cause. If such cause exists any funds the government received as a penalty were illegally taken in violation of the BSA and the taxpayer can pursue a refund in the Claims Court, he said.

Therefore, the APA review is not available for the Kenteras because they can bring their claims in the Claims Court under the Tucker Act, Judge Stadtmueller said. They have an adequate remedy to replace APA review, and as a result, the government did not waive its sovereign immunity, he said, dismissing the suit without prejudice. WJ

Related Filing:
Opinion: 2017 WL 401228

See Document Section A (P. 21) for the opinion.

CASE AND DOCUMENT INDEX

