Powerful Consumer Right Hiding in Plain Sight

Much has been made of Dodd-Frank's limitation on arbitration in mortgage loans, but the same provision offers consumers other important rights, hiding in plain sight. The Dodd-Frank Wall Street Reform and Consumer Protection Act adds a new TILA provision, 15 U.S.C. § 1639c(e).[1] Section 1639c(e)(1) prohibits arbitration clauses in mortgage loans.[2] Even more significant may be § 1639c(e)(3) that provides that no provision of a mortgage loan or other agreement between the parties shall be applied or interpreted to bar a consumer from bringing a court action for damages or other relief in connection with a violation of federal law.[3]

Section 1639c(e)(3) thus goes beyond (e)(1) by not just prohibiting arbitration but also prohibiting the *application* of an arbitration requirement or *any* other provision that would bar a consumer from bringing a court action for violation of a federal law. Thus the (e)(3) provision may prevent application of mortgage requirements that a consumer provide notice before suing or a consumer's release of certain claims in a loan modification. The (e)(3) provision should also limit application of contractual limitations on class actions, punitive damages, consequential damages, attorney fees, or equitable relief.

Scope of the Provision

Significantly, (e)(3)'s limitations apply only to federal law claims, so that the limit on application of arbitration agreements and other waivers of the right to seek court relief cannot be applied to a consumer's state law claims. Section (e)(1) prohibits the inclusion in a mortgage agreement of an arbitration requirement, whether that requirement applies to federal or state claims.

Both (e)(1) and (e)(3) apply to residential mortgage loans and open-end consumer credit plans secured by the consumer's principal dwelling.[4] The corresponding Regulation Z provision makes clear that only open-end credit must be secured by the consumer's *principal* dwelling, and that other mortgage loans need only be secured by a dwelling and *not* the consumer's principal dwelling.[5] This statute is not restricted to purchase money or first mortgages, but applies to second mortgages, reverse mortgages, and any other consumer credit transaction secured by a mortgage, deed of trust, or equivalent consensual security interest on a dwelling or residential property that includes a dwelling.[6]

Thus the statutory limits on arbitration apply to any mortgage loan secured by a dwelling, and dwelling is defined to include a residential structure which contains one to four housing units, manufactured homes, or individual units of condominiums or cooperatives.[7] Regulation Z clarifies that a dwelling need not be attached to real property and includes a mobile home or trailer if it is used as a residence.[8] The official interpretations add boats and vacation or second homes.[9]

Effective Date and Retroactive Effect

The Consumer Financial Protection Bureau has issued, effective June 1, 2013, Regulation Z provisions relating to the TILA restrictions on arbitration and other statutory waivers in mortgage loans.[10]

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[1] 15 U.S.C. § 1639c(e), *as amended by* Pub. L. No. 111-203 § 1414 (July 21, 2010).
[2] See also Reg. Z § 1026.36(h)(1).
[3] See also Reg. Z § 1026.36(h)(2).
[4] 15 U.S.C. § 1639c(e), *as amended by* Pub. L. No. 111-203 § 1414 (July 21, 2010).
[5] 12 CFR 1026.2(a)(19).
[6] 15 USC § 1602(cc)(5).
[7] 15 USC §§ 1602 (w).
[8] 12 CFR 1026.2(a)(19).
[9] Official Interpretation § 1026.2(a)(19)-1, 2.
[10] 12 C.F.R. § 1026.36(h), *as amended by* 78 Fed. Reg. 11,279, 11,413 (Feb. 15, 2013).

Since the statute does not require such implementing regulations, there is an open issue as to whether the statutory provisions have the same June 1, 2013 effective date as the regulations or whether they went into effect on the Dodd-Frank Act's default effective date of July 22, 2010. This issue is discussed at National Consumer Law Center, Truth in Lending § 1.3 (8th ed. 2012), *updated at* www.nclc.org/library, although the case law has pointed toward the later effective date.

Irrespective of the effective date, the question arises whether the TIL limitations to arbitration and statutory waivers apply to mortgage loan agreements consummated *before* the statutory provision's effective date (be it June 1, 2013 or earlier). The answer to this question may be different for the (e)(3) provision than for the (e)(1) provision.

The (e)(3) provision's language prevents any mortgage loan provision from being "applied or interpreted," thus implying that it affects the application of an arbitration clauses existing prior to the statute's effective date, as long as the attempted application of the arbitration clause occurs after the statute's effective date. It makes sense for Congress to be more expansive in the (e)(3) provision than the (e)(1) provision because it, unlike the (e)(1) provision, only applies to claims based upon a violation of a federal statute. [11] Thus even if a court were to find (e)(1) not applied retroactively, the (e)(3) provision by its very language is not retroactively applying to the agreement which may have been made before the effective date, but instead is applying to the current enforcement of the agreement, which is clearly after the provision's effective date.

One reported decision that has addressed the retroactive application of the TILA limitation on arbitration in mortgage loans was issued by a state court that only considered the (e)(1) provision. The case did not involve the (e)(3) provision because no violation of federal law was alleged. While the court found no retroactive application of the (e)(1) provision,[12] this should have no bearing as to whether the (e)(3) provision is applicable to current attempts to enforce older arbitration clauses.[13] Moreover, even as to the (e)(1) provision, the state court's analysis clearly showed how the ruling was a close call that could easily have gone the other way.

The difficulty in determining whether (e)(1) provision is or is not retroactively applied is evident when considering the case law considering the retroactive application of another Dodd-Frank arbitration provision similar to the (e)(1) provision--not similar to the (e)(3) provision. In considering a provision limiting arbitration clauses relating to whistleblowing, the federal courts have split whether the provision is to be applied retroactively--two courts have found the whistleblower provision *should* be applied retroactively[14] and four have come to the opposite conclusion.[15]

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[11] Section 1639c(e)(3) relates back to § 1639c(e)(1), but only to adapt that subsection's definition of "extension of credit" and § 1639c(e)(1) does not otherwise limit the application of § 1639c(e)(3). This is evident because 12 C.F.R. 1026.36(h)(2) does not refer back to (h)(1), in part because (h)(2) defines for itself "extension of credit." Thus both the statute and regulation have two independent provisions, one concerning inclusion of an arbitration clause and the other concerning applying the arbitration requirement. Even if one is prospective only, the other can be interpreted independent of the other and to operative retroactively.

[12] State ex rel. Ocwen Loan Servicing, LLC v. Webster, 752 S.E.2d 372 (W.Va. 2013).

[13] But see Weller v. HSBC Mortg. Services, Inc., 2013 WL 4882758 (D. Colo. Sept. 11, 2013) (court fails to notice this difference in the language).

[14] Wong v. CKX, Inc., 890 F. Supp. 2d 411 (S.D.N.Y. 2012); Pezza v. Investors Capital Corp., 767 F. Supp. 2d 225 (D. Mass. 2011). *See also* Wong v. CKX, Inc., 890 F. Supp. 2d 411 (S.D.N.Y. 2012).

[15] Taylor v. Fannie Mae, 839 F. Supp. 2d 259 (D.D.C. 2012); Blackwell v. Bank of Am. Corp., 2012 WL 1229673 (D.S.C. Mar. 22, 2012), *adopted by* 2012 WL 1229675 (D.S.C. Apr. 12, 2012); Holmes v. Air Liquide USA, L.L.C., 2012 WL 267194 (S.D. Tex. Jan. 30, 2012), *aff'd on other grounds*, 498 Fed. Appx. 405 (5th Cir. 2012); Henderson v. Masco Framing Corp., 2011 WL 3022535 (D. Nev. July 22, 2011).