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Is there an Emerging Trend in Post-Foreclosure Litigation under Regulation X?

By: Allison Burke, Paul Janowicz and Brian Laliberte
Tucker Ellis LLP**

A new wave of foreclosure litigation may be gaining strength. Lawyers who previously defended foreclosures have transitioned to a plaintiffs' practice focused on holding lenders accountable in the post-foreclosure context. They are using Regulation X to do it. Regulation X contains rules concerning loss mitigation[1] and error resolution[2] procedures. Post-foreclosure Regulation X lawsuits allege both substantive (*e.g.*, failure to review an application) and highly technical (*e.g.*, failure to send acknowledgment of receipt of correspondence) violations of its loss mitigation rules.[3]

Individuals often apply for loss mitigation programs to avoid foreclosure. These programs are offered by lenders and made available through loan servicers.[4] Regulation X provides the procedural framework for implementing such programs. Specifically, borrowers may make applications for loss mitigation either in writing or verbally. Once an application is submitted, lenders and servicers have the right to request information from a borrower in order to analyze the application,[5] but lenders and servicers must follow very detailed rules for accepting and processing the application. Despite efforts to simplify and streamline the loss mitigation process, lenders, servicers, and borrowers still face challenges. For example, borrowers may complain about poor communication, repetitive and endless requests for documents, and a lack of continuity in customer service representatives. Because Regulation X authorizes a private right of action against lenders and servicers for failure to comply with its rules, those complaints do not fall on deaf ears – attorneys are listening and have started filing lawsuits based on alleged Regulation X violations.[6]

** *Allison R. Burke and Paul L. Janowicz are business trial lawyers with Tucker Ellis LLP in its Cleveland, Ohio office. Brian J. Laliberte is a business trial lawyer and the Chair of Tucker Ellis LLP's Financial Services Litigation Practice Group.*

[1] 12 C.F.R. § 1024.41.

[2] 12 C.F.R. § 1024.35.

[3] The Mortgage Servicing Rules promulgated under the Real Estate Settlement Procedures Act (RESPA), 12 C.F.R. § 1024.1, *et. seq*., are more generally known as Regulation X.

[4] 12 C.F.R. § 1024.31.

[5] *Id.*

[6] A borrower may pursue a private cause of action pursuant to 12 C.F.R. § 1024.41(a), and RESPA, 12 U.S.C. § 2605(f)), which provides that "[w]hoever fails to comply with any provision of this section shall be liable to the borrower for each such failure" in an amount equal to "any actual damages to the borrower as a result of the failure; and any additional damages … in an amount not to exceed $2,000."

Although compliance with Regulation X is a fact-intensive analysis, complaints alleging Regulation X violations have been dismissed for failure to state a claim in certain circumstances. Others have proceeded on their merits. None of the pending complaints we have reviewed have gone past the pleading stage.

Our objective here is to identify what may be an emerging trend in post-foreclosure litigation especially in states where the 2008 recession hit homeowners the hardest.

Common Factual Allegations of Non-Compliance with Regulation X

The facts alleged in Regulation X cases are familiar. The borrower is in jeopardy of foreclosure. She applies for loss mitigation. The servicer either denies the loss mitigation application because it is incomplete or requests additional information. Some borrowers contend that no matter the number of times they submit additional information, they are denied loss mitigation because they are told their applications are incomplete.

Faced with the prospect of losing their home and a loss mitigation process they don't believe to be working, borrowers claim the servicer unlawfully refused to review their "facially complete" application. Regardless of whether the application is incomplete, complete, or facially complete, plaintiffs allege that servicers failed to review the loss mitigation application for any number of reasons that may or may not be explained or even explainable. Borrowers then send the servicer a "Notice of Error" under 12 C.F.R. § 1024.35(a). The notice identifies the servicer's alleged errors reviewing the loss mitigation application. The types of errors alleged in the notice vary.[7]

The Notice of Error then causes the borrower and servicer to engage in a seemingly interminable exchange of correspondence. The borrower claims she has provided all of the requested information. The servicer continues to request additional documentation. Locked in this cycle, foreclosure proceeds.

Claims Arising under the Loss Mitigation Procedures

The dominant, recurring general allegation in post-foreclosure Regulation X cases is that the servicer failed to exercise diligence in reviewing the loss mitigation application. As a consequence, the borrower may lose their home in foreclosure, incur allegedly unnecessary legal fees and costs, and suffer other economic damages. The most common claims arise under the following provisions:

- 12 C.F.R. § 1024.41(f), for violation of prohibition on foreclosure referral with a facially complete loss mitigation application pending review.

- 12 C.F.R. § 1024.41(c), for failure to perform a review of the borrower's eligibility for any and all loss mitigation options available to the borrower within thirty days of receipt of a complete loss mitigation application.

- 12 C.F.R. § 1024.41(b), for failure to exercise reasonable diligence in obtaining documents and information to complete a loss mitigation application.

Claims Arising under the Error Resolution Procedures

Similarly, borrowers commonly – and very generally – allege that servicers have failed to follow Regulation X's error resolution procedures. A claim arising from such allegations falls under Regulation X's catch-all

[7] See 12 C.F.R. § 1024.35(b) for a full list of possible errors.

provision, which authorizes a private right of action for "[a]ny other error relating to the servicing of a borrower's mortgage loan."[8]

The most common claims arise from the following alleged violations of Regulation X in the error resolution process:

- 12 C.F.R. § 1024.35(d), for failure to send written acknowledgment of a Notice of Error within five business days.

- 12 C.F.R. § 1024.35(e), for failure to properly respond to or otherwise perform a reasonable investigation into an error alleged by and through the Notice of Error.

Defending the Regulation X Case

While Regulation X claims are fact-intensive, this does not mean that servicers should forego efforts to dismiss claims in an early dispositive motion.

Counsel must candidly assess the facts alleged in the complaint. In *Stallman v. U.S. Bank Nat'l Ass'n*,[9] the Cuyahoga County Court of Common Pleas granted a motion to dismiss for failure to state a claim because the complaint did not plead sufficient facts. Despite filing a 127-paragraph complaint with five different causes of action, including a cause of action for alleged RESPA violations, the plaintiffs relied almost entirely on conclusory language to describe their claims. This proved fatal. The court held that "Plaintiffs' failed to allege a single supporting fact" concerning their RESPA claims.[10]

Complaints that provide detailed fact narratives, like the ones filed in *Quade v. Nationstar Mortg. LLC*,[11] and *Bohon v. CitiMortgage, Inc.*,[12] are unlikely to suffer the same fate. In those cases, each complaint stated more than 200 specific factual allegations. The plaintiffs documented communications with loan servicers that occurred on specific dates and times, the history of their correspondence with the servicers, and the alleged violations of Regulation X. In both cases, the plaintiffs attached copies of relevant correspondence with the servicers to bolster their initial pleadings.

Pleading Regulation X claims using the templates in *Quade* and *Bohon* is highly effective. Utilizing specific allegations and attaching relevant correspondence likely eliminates any opportunity for a successful early dispositive motion for failure to state a claim. The defendants in *Quade* filed an answer, and the parties are currently set for a settlement conference in June 2017. In *Bohon*, the parties settled before Answers were filed.

In cases where defendants answer and proceed on the merits, they would be well-served to focus discovery on the timeliness of a borrower's loss mitigation application. RESPA requires a borrower to submit a completed loss mitigation application to the loan service provider at least thirty-seven (37) days before a foreclosure sale, and the time period is calculated *as of the date the application is received*.[13] In *Garmou v.*

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[8] 12 C.F.R. § 1024.35(b)(11).

[9] No. CV-16-869050 (Ohio C.P. Nov. 2, 2016).

[10] *Id.*

[11] No. 1:16-cv-02669-CAB (N.D. Ohio Nov. 1, 2016) (ECF No. 1).

[12] No. 1:17-cv-0533 (N.D. Ohio Mar. 14, 2017) (ECF No. 1).

[13] 12 C.F.R. §§ 1024.41(b)(3), (c)(1).

Kondaur Capital Corp.,[14] the plaintiff submitted his application just twenty-five (25) days before the date of the announced sale. Although the sale was postponed for more than a year, the district court held that the application was not timely filed and granted the motion to dismiss.[15] It was apparent from the complaint filed in *Garmou* that the plaintiff's claims were barred. Where it is not apparent, defendants must determine whether a loss mitigation application met the timeliness requirements and then consider whether an early summary judgment motion is appropriate.

It seems that once servicers answer complaints, like those in *Quade* and *Bohon*, the choice is to seek an early resolution or to proceed with discovery. The latter option seems fraught with risk. The former, depending on the rate at which Regulation X claims are settled, may be more expedient and less costly than defending the merits.

What's Next?

Lawyers are leading the charge, in Ohio, to use federal regulations in the post-foreclosure context to pursue monetary damages on behalf of homeowners and borrowers who allegedly incurred damages because their lender or servicer did not comply with federal regulations. And they are frequently affiliated with similar firms throughout the country.

For the defense, disposing of Regulation X claims may not be a simple proposition. As the plaintiffs' representatives becomes more attentive to pleading specific factual allegations, the likelihood of winning early dispositive motions in Regulation X cases will likely diminish. Consequently, the potential for settlement before or in the early stages of discovery is worth exploring. Although, it must be remembered that early settlements in this first wave of cases, without any exploration of the merits, may encourage more Regulation X litigation. That is, enterprising lawyers may begin to accumulate Regulation X case inventories that they will file, and attempt to settle, in tranches.

Our assessment, as we watch these cases continue to appear on state and federal district court dockets, is that we are at the beginning of a litigation trend that may last for many years.

[14] No. 15-12161, 2016 WL 3549356, at *4 (E.D. Mich. June 30, 2016).

[15] *Id.* at *4–6.