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Stephen K. Wallant

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# DO TILA RESCISSION RIGHTS “SURVIVE” REFINANCING? HOW THE HOUSING AND ECONOMIC RECOVERY ACT OF 2008 INTRODUCES NEW SOLUTIONS TO AN OLD PROBLEM

STEPHEN K. WALLANT<sup>†</sup>

## INTRODUCTION

Whether it was the breezy pastels, the promise of pastoral idyll (the development was called “Lago Vista”—Spanish for “Lake View”), or just the heady rush of homeownership, Victor and Lorraine bought their first home in 2002 for under one hundred thousand dollars, with nothing down and no closing costs.<sup>1</sup> Husband and wife together earned seventeen thousand dollars per year and now owned a completely leveraged home in the exurban Texas scrub, overlooking the barricaded, flooded waste pit of an abandoned asphalt plant.<sup>2</sup> “The attitude was, ‘Sign here, sign here, don’t read the fine print,’” explained Victor.<sup>3</sup>

Victor and Lorraine were archetypal “subprime” borrowers: Their credit history fell short of traditional norms, but they were eligible for adjustable rate mortgages.<sup>4</sup> Although the couple’s

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<sup>†</sup> J.D. Candidate, 2010, St. John’s University School of Law; B.S., Mathematics, 2002, State University of New York at Albany. I thank Professor Anita Krishnakumar for her great patience and insight. I am also indebted to Lynette Hotchkiss, Esq., for her guidance with respect to Part III.B. Finally, I thank my wife, Song, *sine qua non*.

<sup>1</sup> See David Streitfeld & Gretchen Morgenson, *Building Flawed American Dreams*, N.Y. TIMES, Oct. 19, 2008, at A1 (recounting the story of Victor and Lorraine). Former Chief Executive of Fannie Mae, James Johnson, and Henry Cisneros, former Secretary of the Department of Housing and Urban Development under President Clinton, were directors of KB Home, the construction company for Lago Vista; Cisneros also owned American CityVista, Lago Vista’s developer. *Id.*

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> See *id.*; see also 26 U.S.C.A. § 143(k)(12)(C) (West 2009) (defining a subprime loan as “an adjustable rate single-family residential mortgage loan made after December 31, 2001, and before January 1, 2008, that . . . would be reasonably likely

mortgage “veered close to foreclosure,” they ultimately managed to keep their home.<sup>5</sup>

Others have been less fortunate. Lenders have foreclosed one in five mortgages along Lago Vista’s main drag.<sup>6</sup> Nationwide, foreclosure rates in the second quarter of 2008 reached their highest point since 1979.<sup>7</sup> “Prime” mortgage loan borrowers—homeowners whose credit is sound but who hold variable-rate mortgages—are beginning to suffer ill effects as well as employment rates and property values dwindle and monthly payments rise.<sup>8</sup>

Overall, sinking property values and rising interest rates have converged to make refinancing far more difficult for homeowners who have avoided foreclosure.<sup>9</sup> On July 30, 2008, Congress moved to stem the rising tide of mortgage default and delinquency, enacting the Housing and Economic Recovery Act of 2008 (“HERA”).<sup>10</sup> HERA is a comprehensive piece of legislation, designed to “provide[] homeownership assistance and reforms to mitigate recent increases in foreclosures.”<sup>11</sup> Indeed, HERA “is

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to cause financial hardship to the borrower if not refinanced.”). “Adjustable rate” is shorthand for a rate that starts very low, a so-called “teaser rate” and then increases substantially after some initial period. *See Andrews v. Chevy Chase Bank*, 240 F.R.D. 612, 615 (E.D. Wis. 2008), *rev’d on other grounds*, 545 F.3d 570 (7th Cir. 2008) (denying class certification), *cert. denied*, 129 S. Ct. 2864 (2009).

<sup>5</sup> Streitfeld & Morgan, *supra* note 1.

<sup>6</sup> *Id.*

<sup>7</sup> Vikas Bajaj, *Foreclosures Rose as Delinquencies Eased in Quarter*, N.Y. TIMES, Sept. 6, 2008, at B8.

<sup>8</sup> Vikas Bajaj, *Housing Lenders Fear Bigger Wave of Loan Defaults*, N.Y. TIMES, Aug. 4, 2008, at A1.

<sup>9</sup> *See Madlen Read, Rate Cut Loosens Credit Only at the Margins*, INT’L HERALD TRIB., Oct. 9, 2008 (noting a “stubbornly high” London Interbank Offered Rate (“LIBOR”), an index reflecting the interest rate at which banks will loan to each other, and to which many adjustable-rate mortgages are tied); *see also* Vikas Bajaj, *Home Prices Are Seen as Far from Bottom*, N.Y. TIMES, Oct. 16, 2008, at A1 (noting that dwindling employment rates and disproportionate home-price-to-rent ratios are driving the decline in home prices, while home loan interest rates rise steeply); *Questions and Answers: Mortgage Rates, Defaults on Minds*, DETROIT FREE PRESS, Oct. 2, 2008, at 9.

<sup>10</sup> Pub. L. No. 110-289, 122 Stat. 2654 (2008).

<sup>11</sup> Press Release, White House Office of Communications, President Bush Signs the Clean Boating Act of 2008 and the Housing and Economic Recovery Act of 2008 into Law (July 30, 2008), *available at* 2008 WL 2911757. HERA’s wide scope is shown in the President’s press release, which reads:

The Housing and Economic Recovery Act of 2008, which authorizes the Department of the Treasury to purchase obligations of housing Government Sponsored Enterprises (GSEs); reforms the regulatory supervision of the housing GSEs; provides reform of the Federal Housing

regarded as the most wide-ranging and significant housing law since the Great Society, an attempt to deal with a national housing crisis the likes of which hasn't been seen since the Great Depression."<sup>12</sup>

A primary goal of HERA is to enable refinancing for homeowners facing foreclosure through an innovative program called "Hope for Homeowners" ("Hope").<sup>13</sup> Hope retools the Federal Housing Administration ("FHA") to insure the refinancing of mortgages in danger of foreclosure and markets a variety of federal refinancing options to mortgage holders and borrowers.<sup>14</sup> Hope is part of HERA's dominant theme to "provide refinancing opportunities under fiscally responsible terms," especially for high-risk borrowers and loans.<sup>15</sup>

In addition to its remedial focus, HERA is also prophylactic: It looks forward to prevent borrowers and lenders from entering into damaging subprime loan transactions.<sup>16</sup> A sharp arrow in HERA's prophylactic quiver is the strengthening of disclosure requirements in the already extant Truth in Lending Act ("TILA").<sup>17</sup> Congress enacted TILA<sup>18</sup> in 1968 to "assure a meaningful disclosure of credit terms" to consumers and to promote "economic stabilization."<sup>19</sup> TILA mandates disclosure of the real cost of consumer credit through the standardized annual percentage rate of interest ("APR"), which takes account of all

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Administration; provides homeownership assistance and reforms to mitigate recent increases in foreclosures; and contains housing-related tax incentives and other tax provisions.

*Id.*

<sup>12</sup> Staff Reports, *What Housing, Lending Groups Say About Law*, THE OKLAHOMAN, Aug. 2, 2008, at 2B (trade groups' reactions to HERA). "This is the most important piece of . . . legislation in more than a generation." *Id.* (quoting Kieran P. Quinn, Chairman of the Mortgage Bankers Association).

<sup>13</sup> See 12 U.S.C.A. § 1715z-23 (West 2009).

<sup>14</sup> *Id.*

<sup>15</sup> American Housing Rescue and Foreclosure Prevention Act of 2008, H.R. 3221, 110th Cong. § 111(2) (2008). This bill became part of HERA. See HERA, § 1402.

<sup>16</sup> See, e.g., 12 U.S.C.A. § 5101 (West 2009) (encouraging states to create a "Nationwide Mortgage Licensing System and Registry" to "[f]acilitate[] responsible behavior in the subprime mortgage market place and provide[] comprehensive training and examination requirements related to subprime mortgage lending").

<sup>17</sup> See HERA, § 2502 (amending 15 U.S.C. §§ 1638, 1640); see also Michelle Singletary, *Don't Fall for the Mortgage Rip-Offs*, WASH. POST, Aug. 3, 2008, at F1 (explaining that § 2502 of HERA "requires clear disclosure to ensure that borrowers know their maximum monthly payment—based on the . . . terms of their loan").

<sup>18</sup> See 15 U.S.C. §§ 1601–1667f (2006).

<sup>19</sup> *Id.* § 1601(a).

interest, fees, and other finance charges for which the consumer is liable.<sup>20</sup> In principle, TILA was designed precisely to remedy the sort of uninformed consumer activity that underlies the current crisis: borrower ignorance of the real cost of subprime mortgage credit.<sup>21</sup>

Where a lender has failed to deliver certain “material disclosures,” TILA provides mortgage loan borrowers with a powerful rescission remedy that persists for three years after the transaction is completed.<sup>22</sup> Courts have differed, however, over the availability of TILA rescission rights where a borrower refinances the mortgage transaction during the three-year period. For example, in *King v. California*,<sup>23</sup> the Ninth Circuit found rescission rights enforceable only if an outstanding mortgage lien secured the transaction that the plaintiff sought to rescind.<sup>24</sup> Mortgage liens are unique among credit transactions governed by TILA because they are the only kinds of security interests that potentially give rise to the remedy of rescission.<sup>25</sup> The court reasoned, therefore, that when the plaintiff refinanced

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<sup>20</sup> See *id.* § 1606(a) (APR); *id.* § 1605(a) (finance charge); *id.* § 1638(a) (requiring disclosure).

<sup>21</sup> See Streitfeld & Morgenson, *supra* note 1 (buyers in Lago Vista “were duped into believing it was easier than it was [to get financing]” (quoting Victor Ramirez)); see also Jilian Mincer, *Getting Personal: Mtge Lawsuits Could Bail Out Some Borrowers*, DOW JONES NEWSWIRES, July 13, 2007 (“The subprime market has been known for its lax standards in documentation.”). While lenders’ relaxed credit standards and overall poor vetting of borrowers partly explain the recent prevalence of subprime loans, see Streitfeld & Morgenson, *supra* note 1, another contributing factor is lenders’ failure to disclose the real cost of credit—the very evil that sparked TILA’s enactment forty years ago. See 154 CONG. REC. E1602-01, 1602 (daily ed. July 23, 2008) (statement of Rep. Baca) (noting “the fact that many consumers facing foreclosure on their homes who have adjustable rate mortgages never understood how their loan products worked or how high their payments would be once their loans reset” as a cause of the rise in foreclosure rates); see, e.g., *Andrews v. Chevy Chase Bank*, 240 F.R.D. 612, 618–19, 622 (2007) (finding adjustable rate mortgage loan disclosures to plaintiff insufficient, and estimating 7,000 other customers of defendant bank to have suffered similar deficiencies), *rev’d on other grounds*, 545 F.3d 570, (7th Cir. 2008) (denying class certification); see also Mincer, *supra*; 15 U.S.C. § 1601(a); *infra* notes 33–36 and accompanying text.

<sup>22</sup> 15 U.S.C. § 1635(a), (f). Even where lenders deliver the required disclosures, borrowers have an unconditional three-day right to rescind following the delivery. *Id.* § 1635(a).

<sup>23</sup> 784 F.2d 910 (9th Cir. 1986), *cert. denied*, 484 U.S. 802 (1987).

<sup>24</sup> *Id.* at 913.

<sup>25</sup> See 15 U.S.C. § 1635(a) (limiting the right of rescission to transactions in which a mortgage lien is taken on the borrower’s home). TILA, however, applies to many types of consumer credit—albeit secured by personal property, real property, or unsecured. See 12 C.F.R. § 226.1(c)(1) (2009).

the transaction at issue, extinguishing the mortgage lien, and repaying the loan, the rescission right evaporated; there was “nothing to rescind,” as rescission rights persist only until the mortgage lien is extinguished.<sup>26</sup>

Most courts have not followed the Ninth Circuit’s lead. For example, in *Barrett v. JP Morgan Chase Bank*,<sup>27</sup> the Sixth Circuit looked to TILA’s statutory language to bolster its holding that, as a matter of law, rescission rights survive refinancing.<sup>28</sup> Under TILA, certain mortgage transactions are expressly exempt from rescission rights, and even the rescission rights of *nonexempt* transactions terminate upon certain stated conditions—but mortgage loans that have been refinanced are not among the express exemptions, nor is refinancing among the stated conditions.<sup>29</sup> The statute, furthermore, provides the consumer with “the right to rescind the *transaction*,” not merely the mortgage lien.<sup>30</sup> Thus, the Sixth Circuit reasoned, TILA is designed so that consumers retain their rescission rights after refinancing, and the rights apply to the entire “transaction”—an inclusive term encompassing not only the mortgage lien, but also the host of finance charges for which consumers also are responsible.<sup>31</sup>

HERA’s intersection with TILA sheds new light on this circuit split. Although HERA does not directly resolve the issue of borrowers’ rescission rights upon refinancing, HERA offers a well-furnished suite of new programs to facilitate and enable refinancing while girding borrowers with new disclosure protections and remedies.<sup>32</sup> HERA is poised to aid borrowers through a robust, consumer- and lender-oriented refinancing campaign, which would, if the Ninth Circuit’s position stands, *amount to the wholesale destruction of a valuable individual right to rescind under TILA*.

This Note argues that, while the Ninth Circuit’s position in *King* prohibiting post-refinancing rescission of a mortgage transaction does not violate the letter of HERA, it is nevertheless unworkable. It is inconsistent to read HERA to bar TILA

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<sup>26</sup> *King*, 784 F.2d at 913.

<sup>27</sup> 445 F.3d 874 (6th Cir. 2006).

<sup>28</sup> *Id.* at 876–78, 880.

<sup>29</sup> *Id.* at 878–79; see 15 U.S.C. § 1635(e), (f).

<sup>30</sup> 15 U.S.C. § 1635(a) (emphasis added).

<sup>31</sup> *Barrett*, 445 F.3d. at 878.

<sup>32</sup> See *infra* Parts II.A, II.B.

rescission rights after refinancing, as the Ninth Circuit would require, in the face of HERA's purpose, intent, language, and legislative history. A *King*-like rule is tantamount to a presumption that Congress enacted HERA with the purpose of destroying borrowers' rights to rescind fraudulent loans. This is an absurd result that should be avoided. Moreover, the Ninth Circuit's position is particularly inequitable in light of its practical effects now, during the subprime mortgage crisis. Borrowers need rescission; to hold them to the rule in *King* is particularly harsh. The *King* rule cannot stand on these changed statutory and factual landscapes.

Part I of this Note will examine TILA generally, the rescission rights to which TILA gives rise, the *King* Court's interpretation, and various courts' responses to *King*. Part II offers a closer look at HERA—its purposes, its empowerment of government agencies to aid in refinancing, and its changes to TILA's disclosure requirements. Part III demonstrates that *King*'s holding is untenable in light of HERA and the crisis it addresses and shows how HERA should be applied to resolve the issue of TILA rescission rights after refinancing to overrule *King*.

## I. TILA EXAMINED

By 1969, consumer reliance on credit had become ubiquitous.<sup>33</sup> While credit was readily available to consumers, credit transactions were complex and outstripped consumer sophistication.<sup>34</sup> In this market, many consumers were underinformed about the true cost of credit, and unscrupulous lenders opportunistically exploited consumer information deficits.<sup>35</sup> Congress enacted TILA to level the playing field,

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<sup>33</sup> See *Mourning v. Family Publ'ns Serv., Inc.*, 411 U.S. 356, 363 (1973) (finding that "[f]rom the end of World War II through 1967, the amount of [consumer] credit outstanding had increased from \$5.6 billion to \$95.9 billion, a rate of growth more than 4 1/2 times as great as that of the economy") (citing H.R. Rep. No. 1040, at 10–11 (1967)).

<sup>34</sup> See *id.* at 363 (finding that, despite the upswing in consumer debt volume, "consumers remained remarkably ignorant of the nature of their credit obligations and of the costs of deferring payment").

<sup>35</sup> See 109 CONG. REC. 2029 (1963) (statement of Sen. Douglas) (articulating consumers' need "to be protected against fraudulent, deceitful, or grossly misleading information, advertising, labeling, or other practices, and to be given the facts [they] need[] to make an informed choice"). Furthermore, legislators realized that "ethical and efficient lender[s] or credit extender[s]" were disadvantaged in an opportunistic credit market. *Id.*; see also Matthew A. Edwards, *Empirical and Behavioral*

explicitly finding that “informed use of credit” by consumers was necessary to achieve “economic stabilization” and “competition among the various financial institutions engaged in the extension of consumer credit.”<sup>36</sup>

Conceivably, Congress could have proceeded down any of several avenues to erase consumers’ information deficits. For example, Congress could have regulated consumer interest rates directly, ensuring equal footing and full disclosure. But, after “years of congressional study and debate,”<sup>37</sup> Congress rejected this top-down approach<sup>38</sup> in favor of a market-based solution—that is, a requirement that lenders make “meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available.”<sup>39</sup>

Congress designed TILA to achieve two aims: microeconomic consumer fiscal health and macroeconomic efficiency and stabilization.<sup>40</sup> Disclosure requirements were thought to accomplish both aims because the information disclosed would, at the household level, help individual consumers to make smart borrowing choices and, at the national level, encourage aggregate consumer restraint during high-growth, high-interest periods.<sup>41</sup> Consumer restraint in an expanding economy would prevent overexpansion and economic “bubbles,” while disclosure of lower rates in a declining economy would encourage more vigorous consumer borrowing, and, ultimately, economic recovery.<sup>42</sup> TILA is a remedial statute that furthers these policies by setting forth broad disclosure rules.<sup>43</sup>

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*Critiques of Mandatory Disclosure: Socio-Economics and the Quest for Truth in Lending*, 14 CORNELL J.L. & PUB. POL’Y 199, 200–01 (2005) (describing the influence of “information asymmetry” on consumer credit transactions).

<sup>36</sup> 15 U.S.C. § 1601(a) (2006).

<sup>37</sup> *Mourning*, 411 U.S. at 363; see ELIZABETH RENUART & KATHLEEN KEEST, TRUTH IN LENDING, § 1.2.1 (2007).

<sup>38</sup> See 113 CONG. REC 2042 (1967) (statement of Sen. Proxmire) (“[TILA] would not regulate interest charges.”).

<sup>39</sup> 15 U.S.C. § 1601(a); see Edwards, *supra* note 35, at 201 n.4.

<sup>40</sup> See 15 U.S.C. § 1601(a); Parker v. DeKalb Chrysler Plymouth, 673 F.2d 1178, 1181 (11th Cir. 1982) (“The Truth in Lending Act has both a public and private purpose to justify its enforcement.”); Edwards, *supra* note 35, at 203–04.

<sup>41</sup> See Edwards, *supra* note 35, at 210–11.

<sup>42</sup> See *id.*; RENUART & KEEST, *supra* note 37, at § 1.1.1.

<sup>43</sup> See *Mourning v. Family Publ’ns Serv., Inc.*, 411 U.S. 356, 364 (1973). TILA empowers the Board of Governors of the Federal Reserve System to promulgate regulations in TILA’s interstices. See 15 U.S.C. § 1604(a) (“The Board [of Governors of the Federal Reserve System] shall prescribe regulations to carry out the purposes



### A. Rescission Provisions

Prior to TILA's mandated, standardized disclosure requirements, consumers faced a baffling array of colorful finance terms<sup>44</sup> without any meaningful way to compare them. TILA's solution was to standardize the definition of "finance charge," require its uniform presentation through an APR, and require lenders to disclose both terms "clearly and conspicuously."<sup>45</sup> Finance charges and APRs are designed to account for any cost the lender may attach to the extension of credit—whether called a fee, rate, charge, or anything else—and to present the aggregate cost in a single, scaled figure.<sup>46</sup> The standardized finance charge and the APR lie at the heart of TILA's disclosure requirements.<sup>47</sup>

If a lender has failed to meet TILA's disclosure requirements and the transaction meets certain criteria, then the consumer's right to "rescind the transaction" will be triggered.<sup>48</sup> First, the transaction must be one for consumer credit.<sup>49</sup> Second, a mortgage lien on the borrower's principal dwelling must secure the transaction.<sup>50</sup> Third, the purpose of the credit must be other than "the acquisition or initial construction of [the] dwelling."<sup>51</sup>

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of this subchapter."). The set of regulations promulgated pursuant to TILA is called "Regulation Z." 12 C.F.R. § 226.1(a) (2009).

<sup>44</sup> See Elizabeth Renuart & Diane E. Thompson, *The Truth, the Whole Truth, and Nothing but the Truth: Fulfilling the Promise of Truth in Lending*, 25 YALE J. ON REG. 181, 184 (2008) (examples); see also 109 CONG. REC. 2029 (1963) (remarks of Sen. Douglas) (noting lenders' use of various fees to "camouflag[e]" credit "which . . . rightfully should be included in the percentage rate statement").

<sup>45</sup> See 15 U.S.C. § 1605(a) (finance charge); *id.* § 1606(a) (APR); 12 C.F.R. § 226.22(a) (APR); 15 U.S.C. § 1632(a) (clear and conspicuous). The "clear and conspicuous" standard recurs throughout the code and the statute. See, e.g., 12 C.F.R. § 226.5(a)(1) cmt. 1 (2009) ("The clear and conspicuous standard requires that disclosures be in a reasonably understandable form.").

<sup>46</sup> See RENUART & KEEST, *supra* note 37, § 1.1.1 (computation examples).

<sup>47</sup> See Renuart & Thompson, *supra* note 44, at 187.

<sup>48</sup> 15 U.S.C. § 1635(a); see also 12 C.F.R. § 226.23(a). TILA also provides for civil liability, 15 U.S.C.A. § 1640 (West 2009), and criminal liability for willful and knowing violations, 15 U.S.C. § 1611(1)–(3).

<sup>49</sup> See 15 U.S.C. § 1635(a). Thus, the credit must be used "primarily for personal, family, or household purposes." 15 U.S.C.A. § 1602(h) (West 2009).

<sup>50</sup> 15 U.S.C. § 1635(a); 12 C.F.R. § 226.2(a)(25) (requiring "an interest in property that secures performance of a consumer credit obligation and that is recognized by state or federal law").

<sup>51</sup> 15 U.S.C.A. § 1602(w) (West 2009) (defining "residential mortgage transaction" as one financing "the acquisition or initial construction of [the] dwelling"); see 15 U.S.C. § 1635(e)(1) (exempting from rescission rights "residential mortgage transaction[s]").

Finally, consumers may not rescind transactions refinancing existing loans with the same creditor, secured by a mortgage lien in the same property.<sup>52</sup> Consumers may, however, rescind *new advances* made under such same-creditor, same-property refinancing transactions.<sup>53</sup> The criterion excluding same-creditor, same-property refinancing has no explicit bearing on the *original* loan: TILA makes no mention of whether the underlying loan is rescindable, but only makes the *refinanced* loan expressly nonrescindable.<sup>54</sup>

If the above requirements are met, a consumer has an unconditional right to rescind for three days after the latest of the following events: “the consummation of the transaction;” delivery to the consumer of rescission forms and information of his right to rescind; or delivery of “the material disclosures required under” TILA.<sup>55</sup> “Material disclosures” include “the annual percentage rate, the finance charge, the amount financed, the total of payments, the payment schedule,”<sup>56</sup> and, for variable-rate mortgages, a statement informing the consumer of the existence of a variable rate.<sup>57</sup> The three-day period is designed “to give the consumer the opportunity to reconsider any transaction which would have the serious consequence of encumbering the title to his home.”<sup>58</sup>

If, however, the material disclosures and rescission information are never delivered, the borrower’s right to rescind persists for three *years* from the consummation of the transaction or until the borrower sells his entire interest in the property.<sup>59</sup> This three-year extension is a remarkably powerful tool for borrowers<sup>60</sup>—lenders would probably call it draconian.<sup>61</sup>

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<sup>52</sup> 15 U.S.C. § 1635(e)(2); see *Barrett v. JP Morgan Chase Bank*, 445 F.3d 874, 879 (6th Cir. 2006).

<sup>53</sup> See 15 U.S.C. § 1635(e)(2); see *Barrett*, 445 F.3d at 879.

<sup>54</sup> See *Barrett*, 445 F.3d at 879–80.

<sup>55</sup> 15 U.S.C. 1635(a). The consummation of the transaction is the time at which the consumer becomes bound as a function of state law. See 12 C.F.R. § 226.2(a)(13) cmt. 1. (2009).

<sup>56</sup> 12 C.F.R. § 226.23(a)(3) n.48; see also 15 U.S.C. § 1635(a) (requiring material disclosure).

<sup>57</sup> See 12 C.F.R. § 226.23(a)(3) cmt. 2.

<sup>58</sup> S. REP. NO 96-368, at 28 (1979), reprinted in 1980 U.S.C.C.A.N. 236, 264; see *Barrett*, 445 F.3d at 880 (characterizing the three day unconditional right to rescind as a “cooling-off period”).

<sup>59</sup> See 15 U.S.C. § 1635(f).

<sup>60</sup> See RENUART & KEEST, *supra* note 37, at § 6.1 n.5.

<sup>61</sup> See *Barrett*, 445 F.3d at 881.

*B. Case Law Interpreting TILA Rescission Rights After Borrower Refinancing*

The question of whether TILA rescission rights survive when the consumer has refinanced the original mortgage loan has split the circuits. Under the Ninth Circuit approach, the consumer's right to rescind vanishes when the original lender releases the mortgage lien pursuant to a refinancing transaction.<sup>62</sup> This approach considers the mortgage lien itself to be the *sine qua non* of the right to rescind.<sup>63</sup> Under more recent case law, refinancing has no effect on the consumer's ability to rescind the original mortgage transaction. If disclosure violations in an original mortgage transaction are sufficient to trigger a right to rescind, that right persists through any refinancing until three years elapse or until the owner sells or transfers the property.<sup>64</sup> Ultimately, HERA is Congress's vindication of the more recent approach and even adds strength to the reasoning behind it.

The first court to evaluate the effect of refinancing on TILA rescission rights was the Ninth Circuit in *King v. California*.<sup>65</sup> That court ruled that the right to rescind a transaction under TILA depended on whether or not the transaction was secured by an extant mortgage lien—thus, refinancing terminated the right to rescind.<sup>66</sup> The defendant lender moved to foreclose a mortgage lien that arose in a November 1981 refinancing of a March 1981 mortgage loan held by the plaintiff.<sup>67</sup> The plaintiff immediately brought suit in federal court to rescind the March 1981 mortgage transaction under TILA.<sup>68</sup> The court

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<sup>62</sup> See *King v. California*, 784 F.2d 910, 913 (9th Cir. 1986).

<sup>63</sup> See *id.*; see also *Mijo v. Avco Fin. Servs. of Haw., Inc.*, 937 F.2d 613 (9th Cir. 1991) (unpublished table decision); *Monaco v. Bear Stearns Residential Mortgage Corp.*, 554 F. Supp. 2d 1034, 1038–39 (C.D. Cal. 2008); *Coleman v. Equicredit Corp. of Am.*, No. 01 C 2130, 2002 WL 88750, at \*2 (N.D. Ill. Jan. 22, 2002).

<sup>64</sup> *Barrett*, 445 F.3d at 877–78; *Handy v. Anchor Mortgage Corp.*, 464 F.3d 760, 761 (7th Cir. 2006); *Andrews v. Chevy Chase Bank*, 240 F.R.D. 612, 621 (E.D. Wis. 2007), *rev'd on other grounds*, 545 F.3d 570 (7th Cir. 2008) (denying class certification); *Pac. Shore Funding v. Lozo*, 42 Cal. Rptr. 3d 283, 287 (Cal. Ct. App. 2006); see also 1 C.F.R. § 226.23(a)(3) (2009) (listing events terminating the right to rescind).

<sup>65</sup> 784 F.2d 910.

<sup>66</sup> See *id.* at 913.

<sup>67</sup> *Id.* at 911–12.

<sup>68</sup> *Id.* at 912. Plaintiff also asserted a number of other federal claims, as well as pendent state law claims. *Id.* at 911, 915–16. TILA damages claims were remanded back to the trial court to consider the applicability of equitable tolling, as were the

refused: “The loan of March 1981 cannot be rescinded[] because there is nothing to rescind. [The plaintiff] refinanced that loan in November 1981, and the deed of trust underlying the March 1981 loan has been superseded.”<sup>69</sup> The Ninth Circuit affirmed its position five years later in *Mijo v. Avco Financial Services of Hawaii, Inc.*,<sup>70</sup> holding that, “When [plaintiffs] refinanced their loan prior to attempting to rescind the loan, their right of rescission under 15 U.S.C. § 1635(f) was extinguished.”<sup>71</sup>

The Ninth Circuit’s analysis, while minimal, is not unreasonable. After all, the right to rescind arises only in a “consumer credit transaction . . . in which a security interest . . . is or will be retained” in the borrower’s dwelling.<sup>72</sup> Hence, the Ninth Circuit’s “seemingly inescapable logic”<sup>73</sup>: As the right to rescind comes to life with the mortgage lien, so it dies with the lien’s abatement through refinancing. How, then, to explain the recent trend in the opposite direction?

Twenty years later, in *Barrett v. JP Morgan*,<sup>74</sup> the Sixth Circuit plunged deeper into the statute’s language and purpose to hold that refinancing does not terminate the right to rescind.<sup>75</sup> In *Barrett*, the borrower sought to rescind two mortgage loans from the same lender, Bank One, dated May 2000, and January 2001.<sup>76</sup> The borrower refinanced both loans in May 2001, with a new lender, prior to suing for rescission.<sup>77</sup> Thus, the mortgage liens arising out of the May 2000 and January 2001 loans had been released, and the borrower was requesting return of finance

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state claims; the trial court’s dismissal of the federal civil rights claims was affirmed. *Id.* at 915–16.

<sup>69</sup> *Id.* at 913. Five months before bringing suit, the plaintiff had discharged her loans in bankruptcy, and title to her home remained vested in the bankruptcy trustee, *id.* at 912, but the court gave no indication its holding was predicated on that fact. See *Monaco v. Bear Stearns Residential Mortgage Corp.*, 554 F. Supp. 2d 1034, 1039 n.6 (C.D. Cal. 2008). Note that, under California law, hypothecation of real property may implicate either a mortgage or the actual conveyance of a deed of trust, but the two security instruments are treated identically. See 27 CAL. JUR. 3D, *Deeds of Trust* § 4 (2009).

<sup>70</sup> 937 F.2d 613 (9th Cir. 1991) (unpublished table decision).

<sup>71</sup> *Id.*

<sup>72</sup> 15 U.S.C. § 1635(a) (2006) (emphasis added).

<sup>73</sup> Stephen F.J. Ornstein & David A. Tallman, *Does Refinancing Terminate a Borrower’s Right To Rescind a Prior Transaction?*, 60 CONSUMER FIN. L.Q. REP. 672, 720 (2006).

<sup>74</sup> 445 F.3d 874 (6th Cir. 2006).

<sup>75</sup> *Id.* at 879–81.

<sup>76</sup> *Id.* at 876.

<sup>77</sup> *Id.*

charges she had paid in connection with those two loans.<sup>78</sup> The defendant, citing *King*, characterized the borrower's rights to return of finance charges as "incidents" to the right to rescind, which vanished upon refinancing.<sup>79</sup>

The Sixth Circuit disagreed with *King*, and the defendant, for three main reasons. First, the court said, there is more at stake in a rescission action than the mortgage lien itself: The statute's language provides not merely for rescission of the mortgage lien, but also for the "right to rescind the *transaction*," a broader term that includes the finance charge.<sup>80</sup> Moreover, TILA requires that the lender both void the mortgage lien *and* return any finance charges that the borrower has paid.<sup>81</sup> This expansive definition is necessary to achieve the objective of rescission: unwinding the entire transaction and placing the parties where they were before entering into their contract.<sup>82</sup> Second, the statute provides four explicit exceptions under which the borrower is not entitled to rescission rights:

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<sup>78</sup> *Id.* In 1989, the plaintiffs took a mortgage loan from Cumberland Bank to buy their home and refinanced that loan through National City Bank. *Id.* In May 2000, this second transaction was refinanced through defendant Bank One. *Id.* In January 2001, the plaintiffs refinanced and consolidated all their debts, including the May 2000 transaction, again with Bank One, which also released all existing security interests in plaintiff's property, and took a new mortgage lien on plaintiff's home. *Id.* Finally, in May 2001, plaintiffs refinanced the January 2001 transaction with a new loan from ABN AMRO. *Id.* As a result of the May 2001, Bank One "released all of its security interests in the Barretts' home." *Id.* JP Morgan Chase Bank is the named defendant as Bank One's successor by merger. *Id.* at 874. Although TILA does not allow rescission for "residential mortgage transaction[s]," 15 U.S.C. § 1635(e)(1) (2006), that is, transactions "financ[ing] the acquisition or initial construction," 15 U.S.C.A § 1602(w) (West 2009), of a home, loans *refinancing* "residential mortgage transactions" are rescindable, as long as the purpose of the *refinancing* is not "acquisition or initial construction." See RENUART & KEEST, *supra* note 37, § 6.2.6.2.1. Thus, the loans at issue in the case are not outside the scope of TILA's rescission rights merely because the loans refinanced (through several intermediate transactions) a mortgage loan whose purpose was the purchase of a home.

<sup>79</sup> *Barrett*, 445 F.3d at 877; see Final Fourth Brief of Appellee/Cross-Appellant at 9, *Barrett*, 445 F.3d 874 (Nos. 05-5035, 05-5146), 2005 WL 5966030 ("[Plaintiffs'] principal argument continues to confuse the incidents of rescission with the right to rescind itself.").

<sup>80</sup> *Barrett*, 445 F.3d at 878 (quoting 15 U.S.C. § 1635(a)) (emphasis added).

<sup>81</sup> *Id.*; see 15 U.S.C. § 1635(b) ("When an obligor exercises his right to rescind . . . he is not liable for any finance or other charge, *and* any security interest given by the obligor . . . becomes void upon such a rescission." (emphasis added)).

<sup>82</sup> See *Barrett*, 445 F.3d at 878. Noting that the term "rescission" is not defined in TILA, the court looked to *Black's Law Dictionary* for its definition. *Id.*

- (1) a residential mortgage transaction . . . ;
- (2) a transaction which constitutes a refinancing or consolidation (with no new advances) . . . of an existing extension of credit by the same creditor secured by an interest in the same property;
- (3) a transaction in which an agency of a State is the creditor; or
- (4) advances under a preexisting open end credit plan if a security interest has already been retained . . . in accordance with a previously established credit limit for such plan.<sup>83</sup>

None of the four exceptions listed include a refinanced loan. Heeding the statute's admonition that, "*except as otherwise provided in this section, . . . the obligor shall have the right to rescind,*"<sup>84</sup> the court thought better of excepting a loan from TILA rescission rights merely because the borrower has refinanced.<sup>85</sup> Finally, the court noted that refinancing does not appear among the conditions subsequent whose occurrence terminates the right to rescind the transaction<sup>86</sup>: the "expir[ation of] 3 years after consummation, . . . transfer of all of the consumer's interest in the property, or . . . sale of the property, whichever occurs first."<sup>87</sup>

Thus, TILA creates "two *statutory* incidents of rescission, one of which is the removal of the security interest, the other of which is the return of the statutorily identified finance charges."<sup>88</sup> If refinancing terminated the right to rescind, lenders could violate TILA, collect finance charges, and refinance the

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<sup>83</sup> 15 U.S.C. § 1635(e). The second exception is revealing. It operates to allow rescission only of new credit, but, by its terms, has no bearing on the original loan. Congress could easily have barred rescission of the original loan here. The court in *In re Steinbrecher*, 10 B.R. 155 (Bankr. E.D. Pa. 1990), read § 1635(e)(2) to allow rescission of the underlying loan where the a borrower had refinanced with the same creditor (secured by the same property). *Id.* at n.20. A "residential mortgage transaction" is one in which the mortgage is created to "finance the acquisition or initial construction of [the consumer's] dwelling." 15 U.S.C.A. § 1602(w).

<sup>84</sup> 15 U.S.C. § 1635(a) (emphasis added); see *Barrett*, 445 F.3d at 879.

<sup>85</sup> See *Barrett*, 445 F.3d at 879.

<sup>86</sup> See *id.* at 878–79.

<sup>87</sup> 12 C.F.R. § 226.23(a)(3) (2009); see also 15 U.S.C. § 1635(f). The court noted that including "sale of the property" among the events terminating the right to rescind shows that Congress considered contexts where a borrower would have repaid the loan and yet did not include refinancing—an anomalous result, unless Congress never intended for refinancing, and consequent repayment, to cut off rescission rights. *Barrett*, 445 F.3d at 878–79; see also *Pulphus v. Sullivan*, No. 02 C 5794, 2003 WL 1964333, at \*17 (N.D. Ill. Apr. 28, 2003) (finding rescission rights to survive refinancing because refinancing is "[c]onspicuously absent" from the list of events in 12 C.F.R. § 226.23(a)(3) and because rescission does not only eliminate the security interest, but also liability for any finance charges).

<sup>88</sup> *Barrett*, 445 F.3d at 880.

loan with impunity, effectively laundering their statutory wrongs and subverting the purpose of TILA, which is to provide consumers with meaningful disclosure.<sup>89</sup>

The Sixth Circuit's powerful reasoning in *Barrett* has not escaped the attention of Ninth Circuit district courts, reluctantly bound by *King*'s precedent. Especially instructive is *Monaco v. Bear Sterns Residential Mortgage Corp.*,<sup>90</sup> decided in the midst of the current mortgage loan crisis in January 2008. There, the borrowers refinanced an existing mortgage with an adjustable rate mortgage loan from Bear Sterns.<sup>91</sup> Fourteen months later, the borrowers refinanced *that* loan.<sup>92</sup> Alleging various nondisclosures, the borrowers, on behalf of a class, sued for rescission of the Bear Sterns loan under TILA.<sup>93</sup> As in *Barrett*, the lender in *Monaco* cited *King* for the proposition that borrowers "cannot rescind because they refinanced their loan, and the deed of trust securing [the lender's] loan has been reconveyed."<sup>94</sup> The plaintiff, acknowledging *King*, urged the court to disregard precedent in favor of foreign circuits' approaches.<sup>95</sup> Ultimately, Ninth Circuit authority forced the court's ruling, but not its *obiter dictum*: "District courts are, of course, bound by the law of their own Circuit, and are not to resolve splits between Circuits no matter how *egregiously in error* they may feel their own Circuit to be."<sup>96</sup>

Bound though it was, the district court had more to offer the borrowers than the cold comfort of dicta. Although it dismissed the TILA rescission claim, the court refused to dismiss claims

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<sup>89</sup> See *id.* at 879. The Seventh Circuit adopted *Barrett*'s reasoning in *Handy v. Anchor Mortgage Corp.*, 464 F.3d 760 (7th Cir. 2006), when it decided that a borrower has the right under TILA to rescind a mortgage loan after refinancing. *Id.* at 765.

<sup>90</sup> 554 F. Supp. 2d 1034 (C.D. Cal. 2008).

<sup>91</sup> *Id.* at 1036.

<sup>92</sup> *Id.* at 1036 n.1.

<sup>93</sup> See *id.* at 1037-38.

<sup>94</sup> *Id.* at 1038.

<sup>95</sup> *Id.* at 1039.

<sup>96</sup> *Id.* (quoting *Zuniga v. United Can Co.*, 812 F.2d 443, 450 (9th Cir. 1987)) (emphasis added) (internal quotation omitted); see also *Velazquez v. GMAC Mortgage Corp.*, 605 F. Supp. 2d 1049, 1060 (C.D. Cal. 2008) ("Whatever *persuasive force the reasoning of [Barrett] may have*, the [Ninth Circuit district court] is not at liberty to follow [its] holdings in the face of contrary binding authority." (emphasis added)).

under California state law.<sup>97</sup> The court based its state law findings in part on the borrowers' colorable claim that the lender failed properly to disclose the APR, the repayment period, and the negative amortization certain to result by automatic operation of the loan's terms.<sup>98</sup> These nondisclosures almost certainly would trigger rescission under TILA (or at least allow a borrower to state a colorable claim for rescission) in a jurisdiction not dominated by *King*.<sup>99</sup>

The court's portrait of TILA rescission rights after *King* bode ill for borrowers who have refinanced in the Ninth Circuit. In that dystopia, as will be shown, HERA's refinancing programs would lead expectant variable-rate mortgagors to the sacrifice of their rescission rights, like lambs to the slaughter.

## II. HOW HERA PROMOTES REFINANCING AND AFFECTS DISCLOSURE AND RESCISSION UNDER TILA

Buckling under the crushing weight of massive nation-wide foreclosure rates, the public placed pressure on Congress to legislate a response, and, on July 30, 2008, HERA was enacted.<sup>100</sup> Through HERA, it was hoped that "troubled homeowners might get relief within days of Mr. Bush signing . . . because lenders have long known details of the legislation and could move quickly to help borrowers refinance."<sup>101</sup> Indeed, encouraging and enabling refinancing for distressed homeowners is a pervasive theme running throughout the nearly seven hundred page

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<sup>97</sup> See *Monaco*, 554 F. Supp. 2d. at 1040–43 (allowing borrower's claims under California's Unfair Competition Law, various common law contract claims including breach of the duty of good faith and fraudulent concealment).

<sup>98</sup> See *id.* at 1041–42.

<sup>99</sup> See 12 C.F.R. § 226.23(a)(3) n.48 (2009) (allowing rescission where the lender fails to disclose the APR, payment schedule, or amount financed); *id.* § 226.23(a)(3) cmt. 2 (rescission for failure to disclose the existence of a variable rate of interest); *id.* § 226.18(f)(1)(iii) cmt. 1 (requiring disclosure of negative amortization for variable rates of interest).

<sup>100</sup> Pub. L. No. 110-289, 122 Stat. 2654 (2008); see 154 CONG. REC. H6854-02, 6988 (daily ed. July. 23, 2008) (statement of Rep. Neal) ("With bank failures and foreclosures continuing to headline the news, the pressure to respond has been most remarkable."); 154 CONG. REC. H6854-02, 6990 (statement of Rep. Emanuel) ("[HERA is] a bipartisan effort to help stabilize the mortgage industry and homeownership.").

<sup>101</sup> Rochelle E. Lento, *The Good, the Bad, and the Ugly*, 17 J. AFFORDABLE HOUSING AND COMMUNITY DEV. L. 301, 302 (2008) (quoting Rep. Barney Frank).



legislation.<sup>102</sup> Theoretically, refinancing should start an economic chain reaction that ends in market liquidity and a relaxed flow of credit.<sup>103</sup> HERA uses a number of techniques to enable refinancing and provides consumers with new rights and remedies under TILA. And all of HERA's effects are to be visited on a public with unexplored TILA rescission rights, a dangerous outcome if rescission rights are as vulnerable to refinancing as *King* would hold.

#### A. *How HERA Promotes Refinancing*

HERA's most significant refinancing provision is the creation of a FHA<sup>104</sup> program called Hope for Homeowners.<sup>105</sup> The

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<sup>102</sup> See *id.* at 303; see also 154 CONG. REC. E1142-02, 1142 (daily ed. June 4, 2008) (remarks of Rep. Rush) (“[HERA] provides much needed mortgage refinancing assistance to combat the symptoms of our stressed, strained, and stagnant economy. [HERA] provides relief and stability to hard working Americans who find themselves threatened with losing their homes.”). HERA also granted broad authority to the Treasury Department to capitalize the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association (that is, Fannie Mae and Freddie Mac, the Government Sponsored Enterprises, or GSEs) through the purchase of GSE-issued common stock or debt securities. See Pub. HERA, § 1117. While this authority was controversial at the time, see, e.g., *New Housing Law: Expanding Federal Powers*, REAL EST. L. REP., at 1 (Sept. 2008) (describing authority as the “most critical [legislative detail of HERA] in the near-term”), it was soon eclipsed by an even broader authority to purchase up to \$700 billion worth of “troubled assets” wherever the Treasury Secretary might find them, granted under the Emergency Economic Stabilization Act, Pub. L. No. 110-343, § 115, 122 Stat. 3765, 3780 (2008) (the “bailout”).

<sup>103</sup> That chain reaction is sophisticated and largely beyond the scope of this Note, but here is an abridged version:

The wave of foreclosures has placed downward pressure on home prices, eroded home equity, and shattered confidence which, in turn, has led to a freezing-up of the mortgage backed securities market, a major source of liquidity and credit to our capital markets. That cascading effect has led to the tightening of the broader credit markets as financial institutions and market participants have been forced to satisfy redemption requests of investors and to hold more capital.

*Private Sector Cooperation with Mortgage Modifications—Ensuring That Investors, Servicers, and Lenders Provide Real Help for Troubled Homeowners: Hearing Before the H. Comm. on Fin. Servs.*, 110th Cong. 15–16 (2008) [hereinafter *Mortgage Modifications*] (statement of Benjamin Allensworth, Senior Legal Counsel, Managed Funds Association.). Effective foreclosure prevention, all else staying equal, would therefore resolve the credit crunch. HERA shows Congress's policy determination that refinancing is an effective way to get these results.

<sup>104</sup> The FHA is “an organizational unit within the Department of Housing and Urban Development,” 24 C.F.R. § 200.1 (2009), whose purpose is the insurance of qualified mortgage loans. See *United States v. McNinch*, 356 U.S. 595, 596–97 (1958); 154 CONG. REC. S2368-04, 2386 (daily ed. Apr. 3, 2008) (statement of Sen.

Program is designed to “insure refinanced loans for distressed borrowers to support long-term, sustainable homeownership.”<sup>106</sup> Three hundred billion dollars is allotted to this end.<sup>107</sup> Hope’s promise of federal insurance against borrower default is designed to give private institutions incentives to refinance at-risk mortgage loans voluntarily.<sup>108</sup> Refinancing is intended to avoid foreclosure and to “help stabilize and provide confidence in mortgage markets.”<sup>109</sup> In this respect, Hope’s goal is consistent with TILA: to promote market stabilization.<sup>110</sup> Under Hope, a sweeping power to refinance through “an auction or bulk refinancing mechanism to facilitate refinancing of existing residential mortgages that are at risk for foreclosure into mortgages insured under this section”<sup>111</sup> is potentially available to refinance the home mortgages *en masse*.

By design, the requirements for Hope eligibility overlap with the problems a borrower is likely to face in repaying a subprime mortgage loan, and subprime mortgage loan nondisclosures tend to trigger TILA rescission rights.<sup>112</sup> Namely, to be eligible for Hope, the borrower must have a high debt-to-income ratio, and the borrower must be unable to repay the loan, as determined by

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Bond) (“FHA is one of our key financing insuring agencies for lower income people.”); 1 MORTGAGES AND MORTGAGE FORECLOSURE IN N.Y. § 15:3 (2009).

<sup>105</sup> HERA, §§ 1401–1404; see *Mortgage Modifications*, *supra* note 103, at 16 (statement of Benjamin Allensworth, Senior Legal Counsel, Managed Funds Association) (“The central element of HERA is Hope for Homeowners . . .”).

<sup>106</sup> 12 U.S.C.A. § 1715z-23(b)(1) (West 2009).

<sup>107</sup> *Id.* § 1715z-23(m). HERA also significantly raises the maximum principal obligation for FHA insurance, rendering more mortgage loans eligible for FHA insurance. *Id.* § 1709(b).

<sup>108</sup> See 154 CONG. REC. E1559-04 (daily ed. July 25, 2008) (statement of Rep. Langevin). This incentive must also counter the possibility that lenders “take significant losses in the form of a reduced loan principal.” *Id.*

<sup>109</sup> 12 U.S.C.A. § 1715z-23(s)(3).

<sup>110</sup> See 15 U.S.C. § 1601 (2006).

<sup>111</sup> 12 U.S.C.A. § 1715z-23(f)(1). Hope’s Board of Directors is charged with implementing regulations and standards under Hope. *Id.* § 1715z-23(c)(3). The Chairperson of the Board of Governors of the Federal Reserve System, a member of the Board responsible for promulgating the regulations pursuant to TILA’s Regulation Z, 12 C.F.R. § 226.1(a) (2009), is also a member of Hope’s Advisory Board. 12 U.S.C.A. § 1715z-23(s)(2); see *supra* note 43 and accompanying text.

<sup>112</sup> See, e.g., *Andrews v. Chevy Chase Bank*, 240 F.R.D. 612, 618–19 (E.D. Wis. 2007), *rev’d on other grounds*, 545 F.3d 570 (7th Cir. 2008), *cert. denied*, 129 S. Ct. 2864 (2009); see also 154 CONG. REC. S5775-01, 5781 (daily ed. June 19, 2008) (statement of Sen. Bond) (arguing that Hope is likely to attract subprime borrowers and lenders).

the HUD Secretary.<sup>113</sup> Hope purposefully spares the struggling borrower any negative fallout, as lenders must also agree to waive all prepayment or refinancing penalties.<sup>114</sup> Holders of liens junior to the mortgage to be refinanced<sup>115</sup> voluntarily must agree to extinguish their interests in the borrower's home.<sup>116</sup> The Board is empowered to negotiate with junior lienholders to gain their assent to extinguishment.<sup>117</sup> In large part, Hope is a federal agency push affecting mortgage borrowers in ways likely to implicate TILA rescission rights, and, through refinancing—if *King* remains good law—affirmatively to endanger TILA rescission rights in the Ninth Circuit.<sup>118</sup>

Understanding the mechanics of Hope's implementation is necessary to understand the impressive scale of refinancing likely to result. Hope amends TILA by creating a fiduciary duty, running from servicers of "pooled [residential] mortgages in an investment to all investors and parties having a direct or indirect interest in such investment."<sup>119</sup> The duty is met if the servicer prudently agrees to refinance "a part or all of the pooled

<sup>113</sup> 12 U.S.C.A § 1715z-23(e)(1). Hope also directs the Secretary of HUD to insure only refinanced mortgages that the borrower is reasonably able to pay. *See id.* § 1715z-23(e)(2)(A); *id.* § 1709(b)(4) (requiring that terms of the refinanced mortgage "[c]ontain complete amortization provisions satisfactory to the Secretary requiring periodic payments by the mortgagor not in excess of his reasonable ability to pay as determined by the Secretary"). Hope also sets the maximum allowable principal obligation of the refinanced mortgage. *Id.* § 1715z-23(e)(2)(B); *id.* § 1715z-23(e)(6).

<sup>114</sup> *Id.* § 1715z-23(e)(3). Additionally, "all fees and penalties related to default or delinquency on the eligible mortgage, shall be waived or forgiven." *Id.*

<sup>115</sup> These liens are almost sure to meet TILA's nonpurchase requirement for rescission. *See* 15 U.S.C. §§ 1602(w), 1635(e)(1) (denying rescission rights for mortgage transactions whose purpose is to "to finance the acquisition or initial construction of [the consumer's] dwelling"); *supra* note 51 and accompanying text.

<sup>116</sup> 12 U.S.C.A. § 1715z-23(e)(4).

<sup>117</sup> *Id.* § 1715z-23(e)(4)(A). As consideration, the Board may offer the junior lienors a portion of the mortgage proceeds of the insured loan, as well as a share of increased equity or sale proceeds resulting from the refinancing. *Id.* § 1715z-23(e)(4)(B)(i); *see id.* § 1715z-23(k)(1)–(2). In negotiating payment, the Board accounts for a number of factors. *Id.* § 1715z-23(e)(4)(B)(ii)(I)–(IV). Notwithstanding the seniority of the mortgage to be refinanced, it may be within TILA's nonpurchase requirement for rescission.

<sup>118</sup> This is especially true in light of the requirement that "[t]he Secretary [of HUD] shall carry out outreach efforts to ensure that homeowners, lenders, and the general public are aware of the opportunities for assistance available under this section." *Id.* § 1715z-23(o).

<sup>119</sup> Pub. L. No. 110-289 § 1403(a)(1), 122 Stat. 2654, 2809 (2008) (codified with some differences in language at 15 U.S.C.A § 1639a(a)(1)). The "servicer" is "the person responsible for servicing of a loan (including the person who makes or holds a loan if such person also services the loan)." *Id.* § 1403(b), 122 Stat. at 2810.

mortgages” in the investment,<sup>120</sup> and the Government Sponsored Enterprises (“GSEs”)<sup>121</sup> also are bound to fiduciary strictures as “servicers.”<sup>122</sup> And, because the duty is folded into TILA’s statutory scheme, the statutory demands placed on the GSEs and other servicers must be interpreted to further TILA’s purpose: economic stabilization through the preservation of consumer rights based on disclosure.<sup>123</sup> While the new fiduciary duty is in itself a sweeping change involving, potentially, another broad statutory power to refinance on a large scale, its true breadth only comes across when read in tandem with HERA’s opening provision.

HERA opens with the creation of the Federal Housing Finance Agency (“FHFA”), a robust new agency designed to oversee the GSEs.<sup>124</sup> The FHFA Director is empowered to set binding goals for GSE purchases of refinancing mortgages and purchase money mortgages.<sup>125</sup> The goal-setting power comes with specificity, great enforcement power, and a specific push to

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<sup>120</sup> *Id.* at § 1403(a)(2), 122 Stat. at 2809; *see* 15 U.S.C.A § 1639a(a)(2)(A)–(C).

<sup>121</sup> The Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association (that is, Fannie Mae and Freddie Mac); *see supra* note 102.

<sup>122</sup> *See* 15 U.S.C.A. § 1639a(f)(2) (defining “servicer”). The definition is identical to that set forth in the Real Estate Settlement Procedures Act (“RESPA”), except RESPA qualifies its definition of “servicer” to *exclude* the GSEs. *See* 12 U.S.C. § 2605(i)(2) (2006). The TILA amendment contains no such restriction. *See* 15 U.S.C.A. § 1639a(f)(2). RESPA and TILA are *in pari materiâ*, compare 12 U.S.C. § 2601(b)(1) (finding enhanced disclosures in consumer real estate settlements necessary) *with* 15 U.S.C. § 1601(a) (same finding for consumer credit transactions), and when

[b]oth acts are *in pari materiâ*, . . . it will be presumed that if the same word be used in both, and a special meaning were given it in the first act, that it was intended it should receive the same interpretation in the latter act, in the absence of anything to show a contrary intention.

Reiche v. Smythe, 80 U.S. (13 Wall.) 162, 165 (1871). The absence of the restriction in the TILA amendment, therefore, shows intent that its “servicer” definition includes the GSEs.

<sup>123</sup> *See* 15 U.S.C. § 1601(a)–(b) (TILA purposes); *see* Karl N. Llewellyn, *Remarks on the Theory of Appellate Decision and the Rules or Canons About How Statutes Are To Be Construed*, 3 VAND. L. REV. 395, 400 (1950) (“If a statute is to make sense, it must be read in the light of some assumed purpose.”).

<sup>124</sup> 12 U.S.C.A. § 4511; *see also id.* § 4513b(a). The FHFA’s authority over the GSEs is broad indeed, including, for example, authority to oversee the GSEs’ prudential business operations, *see id.*, examine books, *see id.* § 4517(a), control executive compensation and golden parachutes, *see id.* §§ 4518(a), (e)(1), and increase capitalization requirements. *See id.* § 4516(c)(1).

<sup>125</sup> *See id.* § 4562(a).

require GSEs to purchase refinancing mortgages.<sup>126</sup> Under HERA, these goals must also include markets beyond the GSEs' former reach.<sup>127</sup> Thus, the FHFA statutorily is required to direct the GSEs more aggressively to purchase a wider variety of mortgage obligations from a broader market; the GSEs, as servicers, prudently must refinance those obligations *en masse* to meet their fiduciary duties. Hope provides incentives and techniques for the GSEs to do so. Moreover, it is likely that many of the affected mortgagors—at least until the point of refinancing—hold latent rescission rights.

### B. HERA's Amendment of TILA Disclosure Requirements

Title V of HERA, the “Mortgage Disclosure Improvement Act,”<sup>128</sup> amends TILA substantially to expand required disclosures and remedies under TILA. The provision's legislative history shows a congressional consensus that inadequacies in TILA disclosure and enforcement caused borrowers to enter into untenable adjustable rate mortgage loans.<sup>129</sup> Widespread borrower default on many of these loans led to the subprime mortgage crisis; thus, HERA's TILA amendments attack the problem at its root.<sup>130</sup>

Under a reasonable interpretation of the new amendments, Congress also has expanded TILA rescission rights to allow rescission for violations of some of the new requirements. First,

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<sup>126</sup> Compare *id.*, with *id.* § 4562(a)(2) (requiring Director to set goals for GSE purchase of “mortgages on owner-occupied, single-family housing for low-income families that are given to pay off or prepay an existing loan secured by the same property,” that is, refinancing mortgages); *id.* § 4562(d)(3); *id.* § 4562(e)(2)(A)(ii); and *id.* § 4562(e)(2)(B)(vi). Mortgages taken to secure a refinancing are probably not purchase money mortgages, and therefore, are more likely to satisfy that requirement for TILA rescission rights. See 15 U.S.C. § 1635(f).

<sup>127</sup> See 12 U.S.C.A § 4565(a) (West 2009). HERA requires that the GSEs purchase mortgages on homes owned by “very low-, low-, and moderate-income families,” *id.* § 4565(a)(1), securing manufactured housing, rural housing, and various types of federally subsidized housing. *Id.* § 4565(a)(1)(A)–(C). These new requirements are a shift from the GSEs' former targets, which excluded mortgages on property owned by very low-income families and left the types of housing to be served largely to the HUD Secretary's discretion. See 12 U.S.C. § 4565; *id.* § 4563.

<sup>128</sup> Pub. L. No. 110-289, § 2501, 122 Stat. 2654, 2855 (2008).

<sup>129</sup> 154 CONG. REC. S2620-03, 2621 (daily ed. April 7, 2008) (statement of Sen. Bond) (explaining the need for the TILA amendment: “[I]n this situation, current protections and oversight have failed. Brokers and lenders did not do enough to disclose to and educate consumers. Regulators also failed here . . .”).

<sup>130</sup> *Id.* at 2621–22.

HERA requires that lenders disclose a wider scope of information, earlier in time, for a wider variety of transactions, especially for adjustable rate mortgages.<sup>131</sup> Second, HERA amends TILA to deepen final disclosures of the payment schedule, finance charge, and APR—each a material disclosure whose omission triggers rescission.<sup>132</sup> HERA does not, however, address directly whether borrowers have the right, under TILA, to rescind mortgages that they have refinanced—the question at issue in *King*.

### 1. The “Good Faith Estimates” Amendment

HERA amends TILA to mandate that lenders provide advance “good faith estimates” of required TILA disclosures for loans *subject to TILA rescission rights*—prior to this amendment, loans subject to rescission did not require advance “good faith estimates.”<sup>133</sup> Among the “good faith estimates” are disclosures whose *ultimate* omission would trigger rescission.<sup>134</sup> The estimates must be made at least seven days before consummation of “any extension of credit that is *secured by the dwelling of a consumer*.”<sup>135</sup> Before HERA, the estimates were due

<sup>131</sup> 15 U.S.C.A. § 1638.

<sup>132</sup> *Id.* § 1638(b)(2)(B) (amending 15 U.S.C. § 1638(b)(2)) (deepening disclosure requirements); *id.* § 1602(u) (material disclosures triggering rescission).

<sup>133</sup> *See id.* § 1638(b)(2).

<sup>134</sup> Lenders must provide “good faith estimates” of a number of disclosures, including finance charges, APRs, and other (ultimately) “material disclosures” for purposes of rescission rights. *Compare id.* §§ 1638(a)(1)–(15) (disclosures requiring “good faith estimates”), *with id.* § 1602(u) (setting forth “material disclosures,” which largely overlap with disclosures requiring “good faith estimates”).

<sup>135</sup> *Id.* § 1638(b)(2)(A) (emphasis added). The extension of credit also must be “subject to the Real Estate Settlement Procedures Act [“RESPA”].” *Id.* § 1638(b)(2)(A); *see also* 12 U.S.C. §§ 2601–2617 (2006) (RESPA). Most refinancing transactions under HERA’s auspices will be subject to RESPA. A loan is subject to RESPA if it is a “federally related mortgage loan,” not given for “business purpose[s].” 24 C.F.R. § 3500.5 (2009) (exempting certain transactions). A mortgage loan, including a refinancing, is “federally related” if:

- (1) It is secured by a “lien on residential real property,” *id.* § 3500.2(b)(1)(i), and the lender is regulated by a federal agency or has its deposits or accounts insured by a federal agency, *id.* § 3500.2(b)(1)(ii)(A);
- (2) The loan “[i]s made in whole or in part, or is insured, guaranteed, supplemented, or assisted in any way” by any federal agency, *id.* § 3500.2(b)(1)(ii)(B); or
- (3) The loan “[i]s intended to be sold by the originating lender to [a GSE],” whether directly or through an intermediary. *Id.* § 3500.2(b)(1)(C).

*See also id.* §§ 3500.2(b)(1)(D)–(F), (b)(2)–(3). The vast majority of refinancing transactions HERA authorizes will, therefore, be within RESPA.

only three days in advance and applied *only* to “residential mortgage transactions,” that is, transactions *not* subject to TILA rescission rights.<sup>136</sup> After this provision, lenders must provide the early estimates for a newly expanded class of loans, to which TILA rescission rights *do* apply.<sup>137</sup> Thus, HERA substantially changes the tenor of transactions rescindable under TILA, requiring a seven-day “cool off” period before consummation during which the consumer may shop for better terms.<sup>138</sup> The seven-day period comes in addition to the three-day “cool off” period after consummation during which time consumers may reflect, compare terms, and, if they wish, rescind.<sup>139</sup>

Courts should interpret lender violations of the “good faith estimates” amendment to give rise to TILA rescission rights. Rescission helps to ensure that lenders make material disclosures for nonpurchase mortgage loans<sup>140</sup>—the same class of loans for which Congress expanded TILA’s advance notice requirements, and the same type of disclosures, in large part, that require advance “good faith estimates.”<sup>141</sup> Moreover, the creation of a seven-day “cool-off” period resembles the three-day “cool-off” period during which consumers unconditionally may rescind.<sup>142</sup> Just as a lender’s failure to make material disclosures deprives the borrower of a valuable reflection period and extends the rescission period for three years, a lender’s violation of the advance estimate requirement frustrates the borrower’s opportunity for reflection. That failure, too, should give rise to a similar opportunity to rescind. After all, if the consumer had the advantage of the seven-day “cool-off” period, he may have reconsidered and never entered into the transaction. A rescission remedy merely preserves the opportunity that Congress created.

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<sup>136</sup> See 15 U.S.C. § 1638(b)(2) (2006) (early disclosures for “residential mortgage transaction[s]” only); *id.* § 1635(e)(1) (exempting “residential mortgage transactions” from transactions giving rise to rescission rights); 15 U.S.C.A. § 1602(w) (defining “residential mortgage transaction”).

<sup>137</sup> See 15 U.S.C.A. § 1635(a).

<sup>138</sup> See Lynette I. Hotchkiss, *Fighting the Failure To Communicate*, BANKING & FIN. SERVS. POL’Y REP., Aug. 2008, at 3.

<sup>139</sup> See *id.*

<sup>140</sup> See 15 U.S.C. § 1635(a).

<sup>141</sup> See 15 U.S.C.A. § 1638(b)(2)(A) (amending 15 U.S.C. § 1638(b)(2)).

<sup>142</sup> Compare 15 U.S.C. § 1635(a), with 15 U.S.C.A. § 1638(b)(2)(A).

## 2. Amendments of Required Final Disclosures

HERA also amends TILA to require new final disclosures that relate to the finance charge, APR, and payment schedule for mortgage loans with adjustable interest rates.<sup>143</sup> The finance charge, APR, and payment schedule are “material disclosures” for purposes of TILA rescission rights.<sup>144</sup> Under the new amendment, lenders must append to the payment schedule the following warning label: “‘Payments Will Vary Based on Interest Rate Changes.’”<sup>145</sup> Lenders must also provide “examples of adjustments to the regular required payment,” including “an example that reflects the maximum payment amount of the regular required payments.”<sup>146</sup> Those examples are to be based on the “maximum interest rate allowed under the contract.”<sup>147</sup>

Although HERA does not expressly allow borrower rescission for failure to append the new warning label disclosure to the payment schedule, courts and administrative agencies should interpret HERA to allow rescission under such circumstances. Rescission is a suitable remedy for a payment schedule that fails to “reflect the terms of the legal obligation between the parties.”<sup>148</sup> HERA’s new warning label requirement signals Congressional recognition of the variable rate term’s central importance to the payment schedule. TILA’s demand that the payment schedule be faithfully disclosed on pain of rescission is gutted if omission of the parts and pieces necessary for a complete disclosure fails to trigger rescission; to fulfill TILA’s purpose, failure to warn must be considered the failure to make a material disclosure sufficient for rescission.<sup>149</sup>

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<sup>143</sup> 15 U.S.C.A. § 1638(b)(2)(C) (amending 15 U.S.C. § 1638(b)(2)) (affecting required disclosures for any “extension of credit that is secured by the dwelling of a consumer, under which the annual rate of interest is variable, or with respect to which the regular payments may otherwise be variable”).

<sup>144</sup> See 15 U.S.C.A. § 1602(u); 15 U.S.C. § 1635(a).

<sup>145</sup> 15 U.S.C.A. § 1638(b)(2)(C)(i).

<sup>146</sup> *Id.* § 1638(b)(2)(C)(ii).

<sup>147</sup> *Id.*

<sup>148</sup> See 12 C.F.R. § 226.17(c)(1) (2009).

<sup>149</sup> See 15 U.S.C. § 1635(f) (failure to make a “material disclosure” triggers three year rescission right); 15 U.S.C.A § 1602(u) (“payment schedule” is a “material disclosure”).



Likewise, officials should interpret the requirement that lenders disclose payment examples<sup>150</sup> as one that, if omitted, triggers rescission rights.<sup>151</sup> Interest is a type of finance charge,<sup>152</sup> and the obligatory payment examples, in disclosing payments and interest rates, are discrete instances of finance charges.<sup>153</sup> Omission, then, is the failure to make a specific material disclosure of the finance charge and should entitle the borrower to an extended rescission right.<sup>154</sup>

In general, TILA poses more stringent "material disclosure" requirements for variable rate loans. Under current law, the failure to disclose even the existence of a variable rate triggers an extended rescission right.<sup>155</sup> It is in keeping with this tendency that the new HERA requirements also should give rise to an extended rescission right.

HERA's amendments to TILA's civil damages provisions also support a conclusion that violation of the amended final disclosure requirements should give rise to a right to rescind. HERA amends TILA to require statutory damages (potentially "twice the amount of any finance charge")<sup>156</sup> for lenders who fail to disclose payment examples.<sup>157</sup> As it stood before, the only nondisclosures that gave rise to these specific statutory damages were failures to make material disclosures that give rise to rescission.<sup>158</sup> HERA expands eligible nondisclosures to include the payment examples, supporting an inference of

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<sup>150</sup> 15 U.S.C.A. § 1638(b)(2)(C)(ii).

<sup>151</sup> See 15 U.S.C.A. § 1602(u); 15 U.S.C. § 1635(f).

<sup>152</sup> See 12 C.F.R. § 226.4(b)(1).

<sup>153</sup> See *id.*

<sup>154</sup> See 15 U.S.C. § 1635(f) (failure to make a "material disclosure" triggers three year rescission right); 15 U.S.C.A. § 1602(u) ("finance charge" is a "material disclosure").

<sup>155</sup> See 12 C.F.R. § 226.23(a)(3), cmt. 2 (stating that "failure to inform the consumer of the existence of a variable rate feature" is sufficient to constitute failure to disclose APR, triggering rescission). Failure to issue the caveat violates this material disclosure as well. See *id.*

<sup>156</sup> 15 U.S.C.A. § 1640(a)(2)(A)(i).

<sup>157</sup> See *id.* § 1640(a) (allowing statutory damages for failure to disclose payment examples required by 15 U.S.C.A. § 1638(b)(2)(C)(ii)).

<sup>158</sup> See 15 U.S.C. § 1640(a) (allowing statutory damages for "failing to comply with the requirements of section 1635," the provision setting forth consumer rescission rights, or for failures to disclose the amount financed, finance charge, APR, total payments, or payment schedule, that is, for failing to make "material disclosures").

congressional intent to treat the new payment example disclosure requirements alongside “material disclosures,” giving rise to the same set of remedies, including rescission.

HERA’s amendments to TILA empower consumers, vesting them with a more robust suite of rights, and demand more thorough lender disclosure. The new disclosure requirements share a powerful affinity with the “material disclosures” whose absence extends borrower rescission rights and ought similarly to be interpreted to extend rescission rights.

### III. HERA IMPLICITLY OVERRULES THE NINTH CIRCUIT’S RULING IN *KING*

HERA leaves a gap by failing to explicitly direct courts or agencies to preserve TILA rescission rights in refinanced mortgage transactions. Such a right is implicit, however, in HERA’s intent, overall purpose, and statutory scheme. To disallow rescission would reduce HERA to an illicit congressional “bait and switch,” and would render the statute internally inconsistent. With the advent of HERA, however, a number of judicial and administrative avenues have opened to resolve the circuit split in favor of allowing TILA rescission rights to “survive” refinancing.

#### A. *HERA’s Intent and Language Demand Allowing Rescission After Refinancing*

HERA shows an unmistakable legislative intent to encourage lenders and borrowers to avail themselves of new refinancing opportunities,<sup>159</sup> preserve borrowers’ existing rights, and even enhance those rights.<sup>160</sup> It is unreasonable to read HERA, a remedial statute protecting borrowers’ equities and explicitly enhancing *some* TILA protections, as stealthily eroding other similar protections.<sup>161</sup> Courts confronted with a borrower who, quite reasonably, has accepted a federal agency-backed offer

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<sup>159</sup> See *supra* Part II.A.

<sup>160</sup> See *supra* Parts II.A, II.B.

<sup>161</sup> This is especially so when one considers the speed with which a borrower could potentially refinance after HERA, increasing the chances that borrowers would surrender rescission rights without any actual input. See Lento, *supra* note 101, at 302 (“[T]roubled homeowners might get relief within days of Mr. Bush signing the bills because lenders have long known details of the legislation and could move quickly to help borrowers refinance.” (quoting Rep. Barney Frank)).

to refinance, must consider the *King* precedent statutorily abrogated by HERA. A contrary reading is tantamount to interpreting one part of HERA to eviscerate some of the same statutory rights that other HERA provisions augment.<sup>162</sup>

A statute's language is the best evidence of Congress's intent.<sup>163</sup> The language of HERA's "Hope for Homeowners" program<sup>164</sup> shows that refinancing should not terminate borrowers' TILA rescission rights. Hope expressly requires that, upon refinancing, "all fees and penalties related to default or delinquency on the eligible mortgage[] shall be waived or forgiven."<sup>165</sup> Hope's language also reveals an intent to avoid negative fallout for borrowers.<sup>166</sup> And yet, the forced surrender of so valuable a right as rescission seems punitive, and its destruction upon refinancing is contrary to Hope's intent to protect borrower rights. A statute must be read to avoid this kind of internal inconsistency;<sup>167</sup> therefore, refinancing must not end the borrower's right to rescind.

The terms of the Hope program also show Congress's intent to provide private lenders with incentives to refinance subprime mortgages through the use of broadened FHA insurance availability.<sup>168</sup> Allowing rescission rights to lie after a Hope refinancing adds to the incentive by offering a hedge against borrower default. The power to rescind after refinancing will lower the risk that a financial institution takes when agreeing to refinance through Hope because, upon rescission, restitution of finance charges from an earlier lender should make the borrower better able to pay the refinanced loan. Much-needed cash would flow from the lender of the underlying loan—who breached a statutory duty under TILA—to the borrower whose loan is refinanced through Hope. The cash then would be

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<sup>162</sup> Courts have found it impermissible to read a statute to eviscerate statutory rights. *See, e.g., Shearson/American Express, Inc. v. McMahon*, 482 U.S. 220, 227 (1987) ("If Congress did intend to limit or prohibit [the statutory right to arbitrate], such an intent will be deducible from [the statute's] text or legislative history, or from an inherent conflict between arbitration and the statute's underlying purposes." (internal quotation and citation omitted)).

<sup>163</sup> *See, e.g., CSX Transp., Inc. v. Easterwood*, 507 U.S. 658, 664 (1993).

<sup>164</sup> *See generally supra* notes 105–111 and accompanying text.

<sup>165</sup> 15 U.S.C.A. § 1715z-23(e)(3) (West 2009); *see supra* note 114 and accompanying text.

<sup>166</sup> *See supra* note 114 and accompanying text.

<sup>167</sup> *In re McBryde*, 120 F.3d 519, 525 (5th Cir. 1997).

<sup>168</sup> *See* 12 U.S.C.A. § 1715z-23; *supra* Part II.A.

available to help the borrower satisfy his obligations to the lender who refinanced under Hope—an additional incentive for private lenders to refinance that offsets the potential for borrower default. Forbidding rescission after a Hope refinancing precludes this salutary result and fails to achieve what Congress intended.

Before a Hope refinancing, however, Hope requires junior lienors' voluntary assent to the extinguishment of their liens, and Congress intended to provide regulators with enough bargaining chips to use in negotiations with junior lienors to win their assent.<sup>169</sup> Regulators may offer reasonable consideration for the junior lienors' assent.<sup>170</sup> Preservation of rescission rights against junior lienors after a Hope refinancing serves Congress's intent by adding a nice bargaining chip to the regulators' stack. If rescission is preserved, lienors are more likely to assent to extinguishment in the hope of offsetting finance charges they would otherwise have to disgorge at a total loss when a borrower rescinds. Should a junior lienor refuse to negotiate, or fail to accept reasonable terms in a negotiation after regulatory scrutiny of the lender's transaction documents, borrower or agency enforcement of TILA remedies might naturally follow.<sup>171</sup>

#### *B. HERA's Purposes Demand Allowing Rescission After Refinancing*

No court could purport to implement HERA's objectives while precluding TILA rescission rights after borrower refinancing. Broadly speaking, Hope shares TILA's purpose of promoting economic and market stability.<sup>172</sup> TILA's express objective to promote efficiency and stability shows Congress's determination that TILA rescission rights are necessary to these ends. Allowing rescission rights to survive an FHA-insured Hope refinancing serves the goal of stabilization from two directions. First, upon rescission, a borrower gets finance charges back from the lender who violated TILA and should pay them to the new lender refinancing under Hope (who presumably has disclosed

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<sup>169</sup> 12 U.S.C.A. § 1715z-23(e)(4).

<sup>170</sup> *See id.*; *supra* note 117 and accompanying text.

<sup>171</sup> *See* 15 U.S.C. § 1607 (2006) (allowing agency enforcement of TILA).

<sup>172</sup> *Compare* 15 U.S.C. § 1601(a) (2006) (declaring economic stabilization as TILA's purpose), *with* 12 U.S.C.A. § 1715z-23(b)(3) (declaring market stabilization as Hope's purpose).

properly). One commentator notes the possibility of a direct transfer of finance charges from the lender who violated TILA to the new refinancing lender.<sup>173</sup> In either case, the capital ends up with the nonfraudulent party—a more economically efficient user.<sup>174</sup> Second, rescission unwinds unfair transactions into which borrowers entered with imperfect knowledge and limited ability to pay, thus placing individual households in less tenuous financial positions.

Preserving borrower rescission rights furthers another important objective of Hope. Hope is designed to provide responsible refinancing opportunities—not to provide a windfall for improvident lenders whose noncompliance helped lead to the housing crisis. Preservation of borrower rescission rights prevents lenders from gaming the system by taking “modest write-off[s]” to avoid the expense and poor return of foreclosing and transferring the risk of their often “fraudulent or negligent . . . treatment of borrowers” to the FHA and the public.<sup>175</sup> Much legislative opposition to the Hope program centered on concerns that Hope refinancing would end in borrower default, insulating lenders at taxpayer expense.<sup>176</sup> Allowing rescission keeps the risk of “fraudulent or negligent” disclosures where it belongs—on the misleading lender who caused loss and must return ill-gotten finance charges—while insulating the public and maintaining the overall soundness of the Hope program. Forbidding rescission after a Hope refinancing is inconsistent with Hope’s objective and undercuts the “fundamental principle that the Congress does not create programs that perpetuate or reward the behavior that led to the housing crisis.”<sup>177</sup>

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<sup>173</sup> See RENUART & KEEST, *supra* note 37, § 6.3.2.3, at 406–07 (noting that the original lender should transfer disgorged finance charges directly to the refinancing lender).

<sup>174</sup> See Richard A. Posner, *The Ethical Significance of Free Choice: A Reply to Professor West*, 99 HARV. L. REV. 1431, 1442 (1986) (noting the economic inefficiency of fraudulent transactions).

<sup>175</sup> See 154 CONG. REC. S5775-01, 5781 (daily ed. June 19, 2008) (remarks of Sen. Bond).

<sup>176</sup> *Id.*

<sup>177</sup> *Id.*

In conjunction with Hope's purposes, HERA's statutory scheme furthers an objective to empower consumers through the direct expansion of TILA requirements and remedies.<sup>178</sup> The consumer empowerment created by HERA's amendments to TILA cannot coexist with a unilateral destruction of TILA's rescission rights. It is absurd to read the statute in a way that assumes Congress would expand rescission rights<sup>179</sup> only to mandate their destruction through refinancing in another provision. Even if the new TILA disclosure requirements were interpreted to provide no expansion of rescission rights,<sup>180</sup> the failure to abrogate *King* is insupportable where Congress has enhanced overall consumer disclosure rights and protections.

HERA accomplishes distinct objectives through creation of the Hope program and empowerment of consumers under TILA; these objectives coalesce in Hope's implementation *through another TILA amendment*.<sup>181</sup> Post-refinancing rescission rights must be preserved to allow the implementation of Hope through TILA. The TILA amendment implementing Hope creates a fiduciary duty running from servicers of pooled mortgages to investors, which servicers can fulfill by refinancing, through Hope, the pooled mortgages they service.<sup>182</sup> And TILA's avowed purpose requires that servicers take advantage of Hope with an eye toward consumers' "informed use of credit" in a manner that enhances "economic stabilization."<sup>183</sup> The explicit purpose of TILA controls the duty of servicers to investors and militates in favor of preserving borrowers' rescission rights—an important enforcement mechanism for ensuring lender compliance with credit disclosure requirements.<sup>184</sup> My analysis is not, however, a

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<sup>178</sup> See *supra* Part II.B.

<sup>179</sup> See *supra* Part II.A.

<sup>180</sup> An interpretation of the new TILA amendments finding no new rescission rights would focus on HERA's failure directly to amend the TILA provision giving rise to rescission rights, 15 U.S.C. § 1635 (2006), or the provision defining "material disclosures," *id.* § 1602(u), to include the new disclosures.

<sup>181</sup> See *supra* notes 119–123 and accompanying text.

<sup>182</sup> *Supra* notes 119–123 and accompanying text.

<sup>183</sup> 15 U.S.C. § 1601(a); see also *supra* notes 119–123 and accompanying text.

<sup>184</sup> See *supra* note 60 and accompanying text. The state agency exception to TILA rescission, see 15 U.S.C. § 1635(e)(3) (exempting "transaction[s] in which an agency of a State is the creditor"), does not operate to preclude rescission here, as the rescindable transaction is the original mortgage transaction *underlying* the federal refinancing.

mere mechanical application of the old interpretive canon dictating that “preambles may be consulted to determine rationale, and thus the true construction of terms.”<sup>185</sup>

To the contrary, as a matter of statutory construction and practical application, the preservation of rescission rights after refinancing is imperative. Preserving rescission rights is crucial to ameliorating many of the practical difficulties Hope’s servicer-fiduciaries will face in deciding whether to refinance the mortgage loans they hold. Refinancing *en masse* through Hope fulfills the servicers’ fiduciary duty only if borrower default “has occurred, . . . or is reasonably foreseeable,” and the “net present value” of refinancing exceeds the “anticipated recovery . . . through foreclosure[.]”<sup>186</sup> But how can a borrower be a safe enough risk for a lender to agree to refinance, if borrower default has occurred or is likely to occur? A servicer’s decision to refinance thus seems to require satisfaction of two directly opposed conditions. Servicers face several obstacles in this situation, and “each of these challenges [has] the potential to undermine foreclosure prevention efforts.”<sup>187</sup>

Rescission goes a long way in addressing the challenges servicer-fiduciaries face in deciding whether to refinance through Hope. First, servicers cite the difficulty in prudently determining that the net present value of refinancing is high where borrower default is likely.<sup>188</sup> Preserving rescission rights will encourage the goal of refinancing because borrowers are in a better position to repay a refinanced loan and avoid default if, after refinancing, they may rescind the underlying transaction and pay the returned finance charges to the new refinancing lender.<sup>189</sup> In the aggregate, the potential availability of this remedy—and its likely investigation by servicers—should increase the net present value of refinancing. Second, servicers worry that, because

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<sup>185</sup> Llewellyn, *supra* note 123, at 403; see 2A NORMAN J. SINGER & J.D. SHAMBIE SINGER, STATUTES AND STATUTORY CONSTRUCTION § 47:2, at 279 (7th ed. 2007).

<sup>186</sup> 15 U.S.C.A. § 1639a(a) (West 2009); see *supra* note 120 and accompanying text.

<sup>187</sup> *Mortgage Modifications*, *supra* note 103, at 62 (written statement of Benjamin Allensworth, Senior Legal Counsel, Managed Funds Association).

<sup>188</sup> See *id.* at 61.

<sup>189</sup> See *supra* note 173 and accompanying text.

most refinancing likely will “fall outside of HERA[,] there is no government guarantee against subsequent defaults,” as newly expanded FHA insurance will apply only to Hope refinancing.<sup>190</sup>

Although not a complete transfer of risk, TILA rescission is a way to remove some risk from lenders refinancing through non-FHA insured loans and place it on those lenders who violated TILA in the first place. Even absent FHA insurance, post-refinancing rescission rights provide a safety cushion that facilitates some servicer refinancing. Rescission’s tendency to place risk on the party breaching a duty—in this case, the statutory duty to disclose under TILA—lightens the burden on server-fiduciaries in the context of an otherwise intractable decision.

### C. *Resolving the Circuit Split*

HERA suggests a variety of judicial and administrative ways to resolve the issue of whether TILA rescission rights survive refinancing. The Ninth Circuit could read HERA as this Note argues and overturn its own outmoded precedent. In some cases, where a borrower reasonably has relied on a Hope outreach program’s offer to refinance,<sup>191</sup> the sheer unfairness of the situation might sway a court through an estoppel argument to prevent the original lender from raising refinancing as a bar to rescission.<sup>192</sup> Alternatively, HERA itself provides a number of opportunities for administrative bodies to address the issue or for further legislative action.

The most obvious administrative solution involves the Federal Reserve Board, which promulgates rules implementing both Hope and TILA.<sup>193</sup> The Board is in a position to consider both statutes, realize the need for the preservation of rescission, and promulgate technical rules assuring the remedy of rescission, at least to borrowers who refinance pursuant to

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<sup>190</sup> *Mortgage Modifications*, supra note 103, at 61.

<sup>191</sup> See supra note 118 and accompanying text.

<sup>192</sup> The argument would probably require the original mortgagee’s complicity in offering refinancing. See *Cardinal Dev. Corp. v. Town of Winchester Zoning Bd. of Adjustment*, 958 A.2d 996, 1001 (N.H. 2008) (establishing the basic elements of estoppel as lender’s knowing “representation or concealment of material facts,” borrower’s ignorance, defendant’s intent that the representation induce plaintiff to rely, and borrower’s reasonable reliance to his detriment (quoting *Phetteplace v. Town of Lyme*, 744 A.2d 630, 631–32 (N.H. 2000))).

<sup>193</sup> See supra note 111.



Hope. In promulgating regulations, the Board should state that refinancing shall not interfere with a consumer's TILA rescission rights.<sup>194</sup> Such a regulation could find a home in Regulation Z or in the Hope regulations.

An interpretation of HERA that overrules *King* and preserves rescission rights will not unduly burden lenders and dry up loan sources.<sup>195</sup> First, preservation of rescission rights does not expand TILA rescission rights beyond their proper breadth: The Sixth Circuit in *Barrett* properly divined the legislature's intent in providing post-refinancing TILA rescission rights,<sup>196</sup> and HERA's silence on the direct question, at the very least, has no effect on an already sound interpretation.<sup>197</sup> The intent, purpose, and language of HERA further support the *Barrett* Court's position. Second, where borrowers respond to HERA's inducements to refinance, rescission under TILA operates to transfer funds from subprime mortgagees—to whom they never belonged—to responsible lenders who have a rightful claim or to the market, where there is a greater need. It also transfers the risk of default on Hope-refinanced loans

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<sup>194</sup> The Board could allow the consumer to waive his right to rescind after refinancing in the face of "bona fide personal financial emergencies," as is allowed under current law regarding TILA rescission rights. 15 U.S.C. § 1635(d) (2006) (authorizing Board to promulgate rules for consumer waiver of rescission rights); 15 U.S.C.A. § 1638(b)(2)(F) (West 2009) (authorizing Board to promulgate rules for waiver of advance disclosure requirements). The Board has the authority to define a "bona fide personal financial emergency," and should use this authority to define the term appropriately for refinancing contexts. 15 U.S.C.A. § 1638(b)(2)(F)(i).

<sup>195</sup> Arguments that the cost of widespread rescission to lenders and the secondary mortgage market "could have disastrous consequences for both organizers of mortgage loans and the secondary market" persuaded Congress in 1995 to amend TILA to raise the tolerance level for disclosure requirements. H. R. REP. NO. 104-193, at 52 (1995); see Truth in Lending Act Amendments of 1995, Pub. L. No. 104-29 § 8, 109 Stat. 271, 276. The amendments came in response to an Eleventh Circuit case allowing rescission for the lender's failure to disclose \$200 in finance charges on a loan in excess of \$100,000. H. R. REP. NO. 104-193, at 52-53 (1995); see *Rodash v. AIB Mortgage Co.*, 16 F.3d 1142, 1143-44, 1148-49 (11th Cir. 1994), *superseded by statute*, Truth in Lending Act Amendments of 1995, Pub. L. No. 104-29.

<sup>196</sup> See *supra* notes 74-89 and accompanying text.

<sup>197</sup> See, e.g., *Sears v. Atchison, Topeka & Santa Fe Ry. Co.*, 779 F.2d 1450, 1452-53 (10th Cir. 1985) (declining to construe legislative inaction on circuit split as instructive). Although the Supreme Court has not addressed the question, a relevant article is William Eskridge, Jr., *Interpreting Legislative Inaction*, 87 MICH. L. REV. 67, 74 (1988) (exploring how legislative inaction, rarely dispositive, may show Congress's acquiescence to prior Supreme Court interpretation).

from taxpayers to subprime lenders. This strengthens the basic equitable argument that a fraudulent gain deserves not protection but rather censure and disgorgement.

#### CONCLUSION

A borrower with a refinanced loan he can afford, in possession of fees he never should have paid on a bad original loan, enjoys greater equity and is in a better position to spend or invest in real property. TILA is a market-based solution, designed to promote macroeconomic stability through private remedies.<sup>198</sup> These remedies, therefore, are well-suited to counteract the problem that “[f]oreclosures not only hurt the families who lose their homes, they hurt neighborhoods, communities and our economy as a whole.”<sup>199</sup> Rescission is a fitting dovetail to recent top-down regulation,<sup>200</sup> allocating private lender liability for disclosure violations and protecting the public fisc against the risk of borrower default on government-sponsored refinancing.

As economist Robert Shapiro explained, “[t]here’s no inexpensive, easy way to address the terms of people’s mortgages’ ”<sup>201</sup> to make them more livable. This is almost certainly true. Nonetheless, rescission for violation of TILA is a market-based solution whose costs need not fall on taxpayers. Moreover, forbidding rescission after refinancing is not in keeping with the dynamic, innovative legislative solution to the subprime mortgage crisis that HERA represents. Rescission after refinancing is, at the least, a well-tailored supplement to HERA and, more likely, a crucial aspect of HERA’s design. Before HERA, a court’s refusal to allow rescission after refinancing probably was inconsistent with TILA. After HERA, denial of rescission rights following refinancing exacerbates foreclosure problems and undermines HERA. Since HERA’s enactment, to deny post-refinancing rescission rights is to ignore HERA’s intent, language, and purpose, and to disregard a factual context that cries out for a contrary result.

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<sup>198</sup> See *supra* notes 40–43 and accompanying text.

<sup>199</sup> Mark Landler, *U.S. Is Said To Be Urging New Mergers in Banking*, N.Y. TIMES, Oct. 21, 2008, at B1 (quoting Treasury Secretary Henry Paulson).

<sup>200</sup> See *supra* note 102 (“bailout” legislation).

<sup>201</sup> Landler, *supra* note 199, at B1 (quoting economist Robert Shapiro).

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