



Featured Article

DO PLAINTIFFS SUING UNDET THE UCL SPELL TROUBLE FOR THE MORTGAGE SERVICING INDUSTRY?

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The mortgage servicing industry has recently faced an increased amount of litigation stemming from the economic downturn that began in 2007. Because a home is one of the most valuable and personal assets a person owns, homeowners are motivated to save their homes, using all colorable legal remedies. In California, one such remedy in default loan litigation is found under the Unfair Competition Law (UCL) (California Business and Professions Code § 17200 et. seq.) Homeowners use this statute in part based on the possibility of being awarded statutory damages provided under the UCL. After California Proposition 64 passed in 2004, it was unclear what was required for an individual to have "standing" to sue under the UCL.

A recent ruling by the Supreme Court of California, in the case of *Kwikset Corp. v. Superior Court* held that under California's Unfair Competition Law, which has been narrowed by Proposition 64, an individual has a private cause of action under the UCL (Bus. & Prof. § 17200 et. Seq.) only if that person has suffered an actual loss of money or property. (2011 WL 240278 (Cal.) pg. 1, citing Voter Information Guide, Gen. Elec. (Nov. 2, 2004) argument in favor of Prop. 64, p. 40)

In *Kwikset*, the court held a plaintiff may sue under the UCL, so long as he/she can prove three things. The first prong of the test is that the person must have sustained an "injury in fact," or an actual, personal injury. The second prong of the test is whether there was a loss of money or property, otherwise known as an economic injury. The court explained that if a person suffers an economic injury, that loss suffices to show "injury in fact." Finally the plaintiff must show a causal rela-

tionship between the injury and the unfair business practice. In other words, the plaintiff must have relied on the actions or statements made by the defendant, and in doing so sustained an injury. (Kwikset pg 5-8)

The court in *Kwikset* had to determine whether the plaintiff had standing to sue the defendant under California's UCL. The plaintiff filed suit against the manufacturer for unfair business practices and false advertising. Plaintiff purchased a lockset labeled "Made in U.S.A.;" however, the lockset was comprised of parts from Taiwan and was partially manufactured in Mexico. The court found that plaintiff suffered a monetary loss

because he purchased the lockset for a certain price, believing that it was "Made in U.S.A." Plaintiff represented that he would not have purchased the lockset for the same price had he known it was made of foreign parts and manufactured outside the United States. Once plaintiff proved the economic injury, he also met the requirement

of injury in fact. Finally, defendant's label "Made in U.S.A." caused plaintiff to purchase the lockset. The court concluded the Plaintiff met the three-part test for standing to sue under the UCL.

After Prop. 64, *Kwikset* preserved a private right of action for plaintiffs who suffer actual economic harm stemming from unlawful, unfair or fraudulent business practices. Because the UCL was designed to protect consumers and competitors alike and to promote fair business practices, it applies not only to goods but services. At first glance it appears that the UCL would apply to the services provided in the lending and bank-

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ing industry; however, according to *Newsom v. Countrywide Home Loans, Inc* (714 F.Supp.2d 1000, N.D. Cal.) claims relating to the origination and servicing of mortgage loans under the UCL are preempted by the Homeowners' Loan Act.

In *Newsom*, a borrower brought a claim under the UCL against his lender for fraudulent business practices. The borrower sued the lender for "1) failing to disclose all material loan terms and the inclusion of false unfair and unconscionable terms, 2) underwriting the loan without due diligence, 3) failing to disclose the yield spread premium to the loan officer, and 4) including loan terms that plaintiffs could not realistically meet." *Id.* at 1012. The *Newsom* court concluded that the plaintiff's UCL allegations were preempted by the Home Owners' Loan Act ("HOLA"). 12 C.F.R. 560.2.

Newsome addressed the scope of HOLA's preemption by stating, "section 560.2(b) sets forth a non-exhaustive list of illustrative examples of the types of state laws that are expressly preempted, which include...terms of credit, loan-related fees, servicing fess, disclosure and advertising, loan processing, loan origination, and servicing of mortgages." *Newsom* at 1010 (citing 12 C.F.R. §560.2(b)). Moreover, if a state law "affects" lending, a presumption arises that it is preempted. *Giordano v. Wachovia Mortg. N.C. Cal.*, 12-14-2010) 2010 WL 5148428, page 4. The UCL is a state law; therefore, causes of action brought under the UCL based on fraudulent or unfair lending operations are likely preempted.

The court in *Newsome* explains that there are three distinct theories of liability under UCL. The theories are: unlawful business practice, unfair business practice and fraudulent business practice. *Newsome* at 1010. Some examples include: unconscionable interest rates and origination fees, inflating financial information on loan applications, and writing loans with attractive initial payments, but including adjustable rates and balloon payments which the applicant cannot afford. See *Newsome* at 1004. This may seem problematic to defendants in banking litigation; however, the *Newsome* court concluded that HOLA preempts claims under the UCL involving servicing or origination of mortgage loans. Under this holding the *Newsome* court dismissed the plaintiff's UCL causes of action.

Given the litigious nature of homeowners in today's economic

climate, there is a strong possibility lenders and servicers will have to defend against claims under the UCL. Although plaintiffs are free to bring suit under the UCL, *Newsome* appears to provide a useful defense against those claims.



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