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Outside Counsel

Lenders Kept Safe From Significant Exposure in Rescission Class Actions

By **David A. Scheffel**

In response to the rise in foreclosures, homeowners are seeking relief under the Truth in Lending Act and other consumer protection laws. In certain instances, homeowners have brought class actions against lenders seeking to rescind their transactions under the act.

However, two federal appeals courts have recently held that these class actions are not viable as a matter of law.

Most recently, in *Andrews v. Chevy Chase Bank*[1] the U.S. Court of Appeals for the Seventh Circuit joined two other circuits prohibiting class actions for rescission.

Congress enacted the Truth in Lending Act (TILA) in 1968 in order to assure a "meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and card practices."[2]

In furtherance of that goal, the act allows a debtor to rescind a consumer credit transaction secured by an interest in the debtor's principal dwelling.[3] That provision comes with guidance on its implementation.

First, the creditor must disclose to the debtor that the right to rescind exists. A proper disclosure contains various items: (1) the retention or acquisition of a security interest in the debtor's principal dwelling; (2) the debtor's right to rescind; (3) how the debtor can exercise the right to rescind, with a form attached for the debtor to use for that purpose, including the address of the creditor's place of business; (4) the effects of rescission; and (5) a clear and easily understandable statement disclosing when the right to rescind expires.[4]

If the creditor has provided proper disclosure of the availability of rescission and a debtor wishes to rescind a credit transaction, the debtor must notify the creditor of the debtor's wish to rescind by midnight of the third business day following the consummation of the transaction or the delivery of the information and rescission forms together with material disclosures, whichever occurs later.[5]

If, however, the creditor has not properly disclosed the right to rescind, the rescission period expands to three years, meaning that the debtor can rescind the credit transaction for three years after its consummation.[6]

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Three circuit courts have thus far addressed whether debtors may bring class actions under TILA's rescission provision. The Seventh and First circuits have recently issued decisions on this, while the Fifth Circuit addressed the issue in 1980.

In September 2008, the most recent decision, the Seventh Circuit held in *Andrews* that debtors may not bring class actions for rescission pursuant to that provision. The court provided a couple of rationales for its decision.

First, the Seventh Circuit discussed the fact that rescission is an individual remedy that does not lend itself to class actions.[7] The court pointed out that rescission is "procedurally and substantively unsuited to deployment in a class action," as it requires individualized unwinding that will vary from transaction to transaction.[8]

Because of that, individual actions would be sure to erupt during and in the wake of the class action, brought by debtors unsatisfied with the class action's effect on their rights.[9] Class actions exist specifically so that type of proliferation may be avoided, such that class actions for rescission under TILA make no more sense than class actions for rescission in any other context.[10]

Second, the Seventh Circuit found that in enacting TILA Congress did not intend that the act would give rise to class actions for rescission.[11] In a different TILA provision, Congress established a damages cap of $500,000 or 1 percent of the creditor's net worth in class actions.[12] Section 1635 provides no corresponding limit for class actions in the case of debtors seeking rescission.[13]

The Seventh Circuit posited that Congress could have intended this omission to mean that rescission may be pursued in a class action context without limit on damages.[14]

Ultimately, however, the court found that it made more sense for Congress to have intended to exclude class actions from Section 1635 entirely, rather than authorize limitless recovery in class actions for rescission.[15]

In *Andrews*, the Seventh Circuit relied heavily on the First Circuit's decision in *McKenna v. First Horizon Home Loan Corp.*, 475 F.3d 418 (2007). In a decision also issued after the beginning of the subprime mortgage crisis, the First Circuit had similarly held that TILA does not give rise to class actions for rescission.[16]

Indeed, the First Circuit "ground[ed] this holding primarily on [the] conclusion that Congress did not intend rescission suits to receive class-action treatment," and stated that "[m]oreover, debtors enjoy an array of private remedies."[17]

Meanwhile, both the First and Seventh circuits cited the Fifth Circuit's 1980 decision in *James v. Home Construction Co. of Mobile*, 621 F.2d 727. In a deci- » Page 6

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a call, an authorized procedure that other officers were not sanctioned for, Judge McCurn held. *Kercado-Clymer v. City of Amsterdam*, 6:07-cv-00086, will be published Thursday.

—Joel Stashenko

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