



2010 MBA Conference Litigation 2: Class Actions and Enforcement Trends

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Roadmap to Today's Talk

- I. RESPA Disgorgement Cases
- II. HUD-OIG's Most Powerful Weapon
- III. FTC Enforcement and CIDs
- IV. State AGs Hiring Private Law Firms to Do The Government's Work



The Take-Away:

This is the toughest federal & state litigation/enforcement climate of our lifetime.

The Economic Crisis was an embarrassment to regulators, and tough enforcement actions are one way to regain face.

The stakes are higher, and the government has more ways to pursue companies, and to do it quicker.

States hiring plaintiffs' law firms on contingency makes the opposition more aggressive.

First, an update: HUD Disgorgement Actions

- In 2007, HUD brought *Jackson v. Property I.D. Corp.*, No. 07-3372 (C.D. Cal. 2007), alleging that LLCs formed by the defendants were not bona fide affiliated business arrangements, but instead were created to provide kickbacks to the co-defendant real estate brokers through advising borrowers to purchase hazard disclosure reports.
- In 2008, the assigned federal judge, in denying the motion to dismiss in that case, held that RESPA allows for not simply injunctive relief, but the **disgorgement of profits** for RESPA violations.
- HUD subsequently settled this lawsuit, but the disgorgement incentive could have created an avalanche of RESPA disgorgement actions.

- This has not happened. Why?
- Perhaps because HUD has had other priorities. RESPA litigation (as opposed to administrative enforcement) has never been high on HUD's radar; the *Property I.D.* case was the first RESPA suit HUD had brought in 20 years.
- Perhaps because the ruling is unpublished, and HUD knows that RESPA disgorgement would be a hotly disputed issue in any future litigation.
- Perhaps because HUD is waiting for legislation that would create disgorgement and other civil money penalties by statute.

Enforcement is a Growth Industry

HUD and OIG are retooling.

1. Forensic Auditors moved from the Office of Investigations to the Office of Audit
2. Forensic Auditors now concentrating their focus on civil prosecutions
3. Greater coordination with U.S. Attorneys' Offices
4. U.S. Attorneys' Offices increasing staffing for more cases coming from HUD.



HUD's Office of the Inspector General ("OIG").

- Created by the Inspector General Act of 1978
- Purpose:
 - (1) conduct and supervise internal audits
 - (2) recommend policies
 - (3) prevent and detect fraud and abuse in agency's programs
 - (4) inform agency head and Congress about effectiveness of agency's programs
- A watchdog, not an attack dog

But, OIG has found a way to make an end-run around HUD-imposed administrative safeguards and limitations, by partnering with U.S. Attorneys Offices . . .

One of HUD's Most Potent Weapons: 18 U.S.C. §1345: Injunctions Against Fraud

- A criminal statute
- However, used to start a civil case because it permits DOJ to begin a civil action to obtain a TRO to prevent continued wire fraud, mail fraud, fraud against the US, banking law violations, or health care offenses
- Authorizes government to file for a temporary restraining order in federal court

Why is 18 U.S.C. §1345 such a potent statute?

- If granted, it is game over.
- Not only can the government freeze assets, but it can enjoin defendants from conducting their normal business operations.
- No loan originations.
- No accepting of monies in payment.
- While the TRO is in place, you are effectively closed.

Why is 18 U.S.C. §1345 such a potent statute?

- Easier to get than a regular preliminary injunction.
- Government will argue that it only needs to show “probable cause,” i.e., that it is more likely than not that the defendant is committing the alleged offense(s).
- This is the easiest evidentiary burden to meet.
- This will be the first step the government takes, and it will be applied for and granted within the first day or two of the government’s filing its case.

What must the government show for a §1345 TRO?

- (1) Fraud is ongoing or is about to be perpetrated, *and*
- (2) injunctive relief is needed to prevent “substantial injury.”

What does substantial injury boil down to?

Government-insured loans that are defaulting at a higher-than-average rate

- Harm is presumed, once illegal activity is demonstrated.
U.S. v. Fang, 937 F. Supp. 1186 (D. Md. 1996).
- Government need not prove irreparable harm to get the TRO.
U.S. v. Quadro Corp., 928 F. Supp. 688 (E.D. Tex. 1996).
- However, proof of irreparable harm shows substantial injury.
U.S. v. Barnes, 912 F. Supp. 1187, (N.D. Iowa 1996).

When facing a §1345 TRO, or FHA-Authority Withdrawal, you cannot wait to respond to what the government does.

VITAL: have a response in place *before* the government acts.

Time is of the essence.

Effective Responses to §1345 TRO and/or MRB action:

- Fact-intensive
- Affidavits
- Exhibits and documentation
- Internal audits
- External vendor reviews and reports
- Easiest to do if done in advance



Effective Responses to §1345 TRO:

- Strong legal arguments
- Briefs prepared in advance can help tip the Court in your favor.



Effective Responses to §1345 TRO:

- Push for a fairer standard, force the government to prove its case by a preponderance standard; don't have to settle for a probable cause standard like a criminal defendant;
- Section 1345 is only for *ongoing* offenses;
- The government is taking drastic action; show the Court that there's no need to close a successful business and put hundreds of people out of work.

Part 3. FTC Enforcement Actions

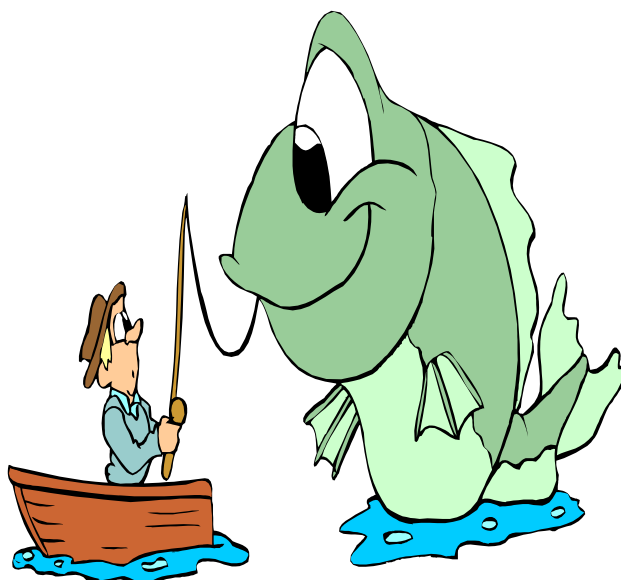
Three painful letters:

C.I.D. (Civil Investigative Demand).

Authority: 15 U.S.C. § 57B-1

“Whenever the Commission has reason to believe that any person may be in possession, custody, or control of any documentary material or tangible things, or may have any information, relevant to **unfair or deceptive acts or practices in or affecting commerce** . . . the Commission may, before the institution of any proceedings under this subchapter, issue in writing, and cause to be served upon such person, a civil investigative demand requiring such person to produce such documentary material for inspection and copying or reproduction, to submit such tangible things, to file written reports or answers to questions, to give oral testimony concerning documentary material or other information, or to furnish any combination of such material, answers, or testimony.” 15 U.S.C. §57B-1(c)(1).

It's a fishing expedition.



An open-record search of your company,
by the government.

FTC's Goals with a CID

- Has a broad mandate, “unfair or deceptive acts or practices in or affecting commerce.”
- Issues a broad demand for documents, sometimes, hundreds of thousands of documents.
- FTC expects a quick reply; expecting documents to be produced in 3-4 weeks.

Defending Against a CID:

- Try to limit the scope of the CID;
- Try to increase time for response;
- May have to move to quash the CID;
- Key to quash: showing that the CID is “unduly burdensome” or “not reasonably related” to FTC’s enforcement and oversight powers.

CIDs: What is FTC Looking For?

ECOA & Fair Lending Compliance. Advertisements & Other Marketing Tools. Underwriting Activities. TILA Compliance. FCRA Violations. Violations of the FTC Act (unfair & deceptive trade practices).

Recent CIDs that we have dealt with appear to be aimed at identifying Spanish-language communications with Spanish-speaking borrowers.

The FTC has a separate task force, the “FTC Hispanic Initiative,” which focuses on how Hispanic consumers are treated in the marketplace. The interplay between communications in Spanish and English is a key component of the FTCs investigations.

FTC’s handling of this issue in other contexts includes . . .

FTC Enforcement Actions

The FTC charged a mortgage foreclosure “rescue” company with seeking out and falsely promising Spanish-speaking consumers who were behind on their mortgage payments that it would stop foreclosure. According to the complaint, many people who paid the defendants ultimately lost their homes; others avoided foreclosure only through their own efforts. On the FTC’s motion, a federal court temporarily halted the defendants’ practices and **froze their assets**, pending trial. *FTC v. Dinamica Finaciera, LLC, et al.*

The FTC charged a marketer of a work-at-home scheme for targeting Spanish-speaking consumers throughout the United States and in Puerto Rico. The scheme advertised in Spanish, promising inflated rates of pay, as much as \$1,400 per week, for stuffing envelopes from home. When the marketer refused a court order require him to cease operations, the **defendant was jailed for contempt of court**. *FTC v. Zolio Cruz, d/ba Int’l Mtg.*

A Texas-based mortgage broker targeted Hispanic consumers for mortgage refinancing. The broker conducted his business transactions with clients in Spanish and promised them favorable terms. But, at closing, the documents were entirely in English, and at less-favorable terms that those verbally promised. **Over \$200,000 in civil penalties against the Broker**. *FTC v. Mortgages Para Hispanos.com Corp., et al.*

Where the FTC Goes, the States Follow

Many states are enacting laws to add greater protection for non-English speakers during consumer finance transactions.

- In California, loan documents must be translated into the language used to conduct the verbal negotiations, including Spanish, Chinese, Tagalog, Korean, or Vietnamese, if the transaction is subject to the California Finance Lender's Law, Industrial Loan Law, or California Residential Mortgage Lending Act.
- In Florida, advertisements in languages other than English must also have limitations and/or disclosures required to be contained in the advertisement, made in the language of the advertisement.
- In Oregon, mortgage brokers, bankers and originators that advertise and negotiate in a language other than English must provide the GFE, TILs, and a notice advising the borrower find a translator, in both English and the other language.
- Texas, Nevada, Kansas and Arizona require Spanish language versions of loan documents for certain, limited products such as second-lien loans and high-interest loans.

State AGs Outsourcing Their Work

Consequence of the Economic Crisis:

Demand for State Enforcement Actions are **up**, but State Attorneys General budgets have been going **down**.

In 2008 alone, State Attorneys General brought over 8,000 enforcement actions against the mortgage lending industry, ranging from violations of state consumer protection laws to civil and criminal RICO actions.

Consequence of the Economic Crisis:

Consumer Credit cases are expensive.

- Complex facts
- Complex law
- Sophisticated financial transactions
- High-volume of documents
- Extensive commitment of time and resources

Solution: Let Private Law Firms Do the Work of the Attorney General's Office!

- Saves the State Money
- Contingency Fee arrangements provides incentives for plaintiffs' firms

Some States “Outsourcing” their AGs Offices:

Arizona California Colorado Georgia

Florida Illinois Indiana Iowa Kansas Michigan

Mississippi Missouri Nebraska Nevada

New Mexico Ohio Oklahoma Pennsylvania

Rhode Island South Carolina Tennessee Texas

West Virginia

PROBLEMS:

- Must comply with strict statutory framework
- Ethical problems: conflicts of interest
- Must work to higher ethical standard
- Due process violations

Strategies to Fight Back:

- Examine state-specific authority to hire outside counsel
- Examine ethics rules; many firms become outside counsel because they've already been involved in other cases in the subject area and have conflicts of interest
- Contingency fee arrangement creates an inherent conflict of interest; government attorneys must serve the "interests of justice."

Strategy to Fight Back: **Constitutional Due Process.**

- State and federal government attorneys may not have a financial interest in the outcome of the cases which they prosecute. *See, e.g.,* Cal. Gov't Code sections 87100, 87103, and 87105 .
- Only government lawyers take an oath to defend the Constitution.
- Only government lawyers are paid from public funds, ensuring loyalty to the people of the State and the motivation to work in the public interest.
- These vital rules (1) allow for independent and impartial government officers and employees, (2) avoid the appearance of impropriety, (3) keep public confidence in government integrity, and (4) prevent conflicts of interest.

Constitutional Due Process (continued).

- The very nature of contingency fees for plaintiffs' firms hired by States directly undermines the spirit and the letter of the laws that permit and guide public actions.
- The contingency fee arrangement provides for the payment of a fee measured by the success of the action prosecuted.
- This arrangement incentivizes counsel for the State to prosecute defendants for alleged violations of law, *regardless of the merit underlying the claims*, as even settlements result in fees paid to the plaintiffs' law firm.

In Conclusion . . .

- Just as the industry has had to adapt to the new climate, so have the regulators tasked with bringing enforcement actions.
- The changing tactics of enforcement and litigation have produced new challenges for industry
- The stakes are higher, the adversaries more aggressive
- If enforcers are more aggressive, the defense bar will have to be more aggressive too.

In Conclusion . . .

- Prepare defenses *before* §1345 TROs and FHA withdrawal actions are brought;
- File suits *against* the enforcers and their counsel to vindicate your rights;
- No need to be passive.

“The best defense is a good offense.” — V. Lombardi



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