

Liability Exposure for the Mortgage Broker

by

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I. INTRO / STATISTICS

1. Ten years ago, 5% of all mortgage originations were subprime
 2. 2005 - figure at approximately 20%
 3. over \$600 billion in new subprime loans originated in 2006
 4. over \$1.3 *trillion* in subprime loans pending currently
- Subprime loans default and delinquencies have grown steadily
 - Numerous lenders have filed for bankruptcy or ceased writing loans
 - According to Wall Street Journal
 - 55 Lenders have simply closed
 - 15 have stopped issuing loans
 - 15 have declared bankruptcy
 - 14 have been acquired by another entity

II. CLAIMS / LITIGATION ON THE HORIZON

A. Pennsylvania Mortgage Fraud Task Force

- Formed 2/4/08 - formed to combat the growing problem of mortgage fraud in Western Pa. area
- Numerous agencies joining forces
 - U.S. Attorney's Office
 - FBI
 - U.S. Secret Service
 - IRS/Criminal Investigation
 - United States Postal Service
 - U.S. Dept. of H.U.D.
 - Pa. Attorney General's office
 - Pa. Department of Banking
 - Pennsylvania Dept. of State
 - Allegheny County Sheriff's Office
- aggressively pursuing anyone who stands in way of "American dream" of owning a home
- industry member hot line to report suspected fraud to task force

- **Recent Indictments**

- Company A:

- M.P. -- Conspiracy, Money Laundering

- J.S. -- Conspiracy

- M.S. -- Conspiracy

- Company B:

- A.F. -- Wire Fraud Conspiracy

- A.F. -- Wire Fraud Conspiracy

- L.F. -- Wire Fraud Conspiracy

- R.F. -- Wire Fraud Conspiracy

- R.C. -- Wire Fraud Conspiracy

- J.J. -- Wire Fraud Conspiracy

- A.M. -- Wire Fraud Conspiracy

- A.R. -- Wire Fraud Conspiracy

- J.D. -- Wire Fraud Conspiracy

- K.F. -- Wire Fraud Conspiracy

- S.S. -- Wire Fraud Conspiracy

- W.F.-- Conspiracy

- Company C:

- S.C.-- Wire Fraud Conspiracy

- C.C.-- Wire Fraud Conspiracy, Money Laundering Conspiracy

- J.C. -- Wire Fraud Conspiracy

- E.S.-- Wire Fraud Conspiracy, Money Laundering Conspiracy

- A.T.-- Wire Fraud Conspiracy

- L.T. -- Wire Fraud Conspiracy, Money Laundering Conspiracy

- Company D:

- D.G.-- Wire Fraud Conspiracy, Money Laundering Conspiracy

- A.T. -- Wire Fraud Conspiracy

- Company E:

- B.T.-- Conspiracy, Bank Fraud, Wire Fraud

- **Recent Convictions**

C. F. - On September 5, 2007, C. F. was sentenced to 200 months of incarceration and five years of supervised release on his conviction for Bank Fraud, Wire Fraud, and Money Laundering.

M.W. - August 30, 2007, M.W. was sentenced in federal court in Pittsburgh, Pennsylvania to 41 months of incarceration and three years of supervised release on his conviction of Conspiracy, Wire Fraud, and Accepting Bribes as a Bank Employee.

K.C. - On July 20, 2007, K.C. pleaded guilty in federal court to a charge of Conspiracy and to a charge of Failure to File Income Tax Returns.

S.W. - On September 18, 2007, S.W. pleaded guilty in federal court to charges of Bank Fraud and Tax Evasion.

B. The industry - civil suits to expect

1. More lenders facing defaults / losses / buy-backs
2. Not just sub-prime, all other loss situation more poignant - first mortgages, regular re-finance loans
3. Lenders will be more aggressive in seeking recourse - first level against the homeowner/property, but losses can actually out-measure value in these situations, so looking for further recourse:
 - brokers
 - appraisers
4. Borrowers who have lost their homes will be seeking recourse
 - brokers
 - appraisers
 - lenders - who will be looking back at the brokers
5. Also Suits by Trustees - Breach of Fiduciary Duties
 - by Underwriting Placement Agents -
 - by Rating Agencies
 - Pension Funds
 - Carriers
 - Mutual Funds
 - Hedge Funds

C. The Lawsuits and Impact of Popular Culture

- Recent article on the MSN Website “Should Your Sue Your Lender?”

 - sets forth in great detail situations where you may have a claim; the lender, if sued, will be looking after you, the broker

- Google search of “subprime loan litigation” turns up countless sites with lawyers asking potential clients if they feel they’ve been defrauded by their lender or broker

- daily newspaper and internet news articles about the refi “crash”

D. The claims specifically directed against the brokers

1. By the lender - typical complaint

- contract claim pursuant to broker agreement
- negligence
- negligent misrepresentation
- fraud/intentional misrepresentation
- breach of warranty
- Unfair Trade Practices and Consumer Protection Law
- Damages
 - compensatory
 - punitive
 - contract
 - treble under UTPCPL

2. By the borrower - typical complaint
 - a. negligence
 - b. breach of contract
 - c. negligent misrepresentation
 - d. fraud/intentional misrepresentation
 - e. predatory lending
 - f. Any of these could be couched in failures to comply with various regulatory provisions:
 - Pa. Department of Banking
 - Secondary Mortgage Loan Act
 - Mortgage Bankers and Brokers and Consumer Equity Protection Act (predatory lending)
 - g. Damages
 - a. compensatory
 - b. punitive
 - c. treble under UTPCPL

E. The bases for borrower claims against brokers, typically, will include any number of the following:

1. broker falsified borrower's income
2. broker falsified his/her fee
3. broker did not give good faith estimate / accurate HUD-1
4. broker gave sub-prime loan when borrower qualified for better loan
5. broker not clear on tax/escrow payments
6. broker double dipping with a YSP (yield spread premium)
7. broker secured "no doc" loans

III. Exposure of Incorporated Mortgage Brokers

- A. One of the topics that is frequently asked when we speak on this subject is: If I am incorporated, my personal assets are not at risk, are they?

The answer to this question can vary depending on your situation. Basically, more often than not, the answer is going to be “yes, your personal assets are at risk,” despite incorporation.

- B. Piercing the Corporate Veil - 3 methods

1. Undercapitalization- basically not maintaining a “safe-harbor” - 10:1 debt ratio for your corporation.
2. Alter-Ego Theory- where the corporation is a mere sham and not really a separate entity from the individual who owns it.
3. Participation Theory- most likely to effect Brokers in a civil litigation situation. (Criminal actions are another situation entirely and require consultation with a criminal lawyer).

A. The individual, who is the owner of the corporation actually participates in the tort (or wrong doing)

B. Personal civil liability can be imposed on the corporate owner if they personally engage in malfeasance, but not if they merely committed nonfeasance.

1 Malfeasance requires an affirmative act of negligence. (if the broker in question personally submitted fraudulent documents to a lender)

2 Nonfeasance is a failure to act. (if the broker failed to properly supervise an employee who submitted fraudulent documents to a lender)

IV. HOW TO PROTECT YOURSELF WITH E&O POLICY / INSURANCE COVERAGE

A. Importance of Obtaining Coverage via Errors and Omissions Policy

- Why “**I didn’t do anything wrong, I’ve got nothing to worry about**” doesn’t work:

1. most of you that will be sued - *probably* didn’t do anything (or much) wrong
2. Example: you use an appraiser that tended to “conform” the appraisal to the amount of money needed
 - may be looking at numerous suits where this appraiser was used, not an isolated claim
 - guilt by association - use of appraiser puts you in hot water
3. You may have obligations under your broker’s agreement with the lender - maybe you didn’t do anything wrong, but you might be legally liable
4. Legal Fees - typical \$2500 or \$5000 deductible - why not just put this toward your defense?
 - a. if magistrate/arbitration - might get away with it
 - b. if appeal, common pleas - easily eaten up
 - c. if federal court - many onerous procedures - recent case over \$30,000 - one lawsuit, settled before trial
5. fees / liability can really place burden on your operations

B. What you get with an E&O Policy

1. Indemnity - you receive protection to the extent you are found liable for damages

Typical Language

We will pay all amounts in excess of the deductible and within the limits of liability applicable to this Policy, that the **Insured** becomes legally obligated to pay as **damages** as a result of a **claim** by reason of an act or omission in the rendering of **professional real estate services** by the **Insured**, or by any person for whom the **Insured** is legally liable, provided that on the First Coverage Date shown on the Declarations, no **Insured** knew or could reasonably have expected that such act or omission, or **related acts or omissions**, would result in a **claim**.

A **claim** must be first made during the **policy period** and must be promptly reported to us in accordance with Section VI, Conditions, paragraph B.

2. Defense - the carrier will hire a lawyer, typically of their choosing, to defend your interests

Typical Language

We shall have the right and duty to defend a **claim** even if any of the allegations of the **claim** are groundless, false or fraudulent. We shall have the right to appoint counsel and to make such investigation, settlement and defense of a **claim** as is deemed necessary by us. If a **claim** is submitted to arbitration or mediation, we shall be entitled to exercise all of the **Insured's** rights in the choice of arbitrators or mediators and in the conduct of an arbitration or mediation proceeding.

We shall not settle a **claim** without the **Insured's** consent. If the **Insured** refuses to consent to a settlement or compromise recommended by us and acceptable to the claimant, then our limit of liability shall be reduced to the amount for which the **claim** could have been settled plus **claim expenses** incurred up to the time we made our recommendation, which amount shall not exceed the remainder of the limit of liability specified in Section III.B..

We are not obligated to investigate, defend, pay or settle, or continue to investigate, defend, pay or settle a **claim** after the applicable limit of our liability has been exhausted by payment of **damages**. In such case, we shall have the right to withdraw from the further investigation, defense, or settlement of such **claim**.

3. Some added benefits under some policies

- loss of earnings for time lost in attending trial/hearings
- assistance in responding to subpoenas, if you are served
- Big Help - more in real estate agent situation, but potentially beneficial here - assistance in defending a licensing board matter, typically up to \$5000

C. Things to Watch - Exclusions / Limitations in E&O policy

1. Deductible
2. Consent to Settle Clause / “hammer” clause
3. Liability Arising Under oral or written contract - potential major problem

Typical Language

We will not defend or pay any **claim**:

Q. based on or arising out of:

1. an **Insured's** alleged liability under any oral or written contract, agreement, guaranty, warranty, promise or representation; or
2. the liability of others an **Insured** assumes under any oral or written contract or agreement,

except that coverage otherwise available to an **Insured** shall apply to an **Insured's** liability that exists in the absence of such contract, agreement, guaranty or warranty.

4. Limitations on Damages

Typical Language

Damages mean judgments, awards and settlements, provided any settlement is made with our prior written consent. **Damages** do not include:

- A. the return or restitution of fees, commissions, expenses or costs;
- B. civil or criminal fines, sanctions, penalties or forfeitures, whether pursuant to law, statute, regulation or court rule;
- C. punitive or exemplary amounts;
- D. the multiplied portion of multiplied awards;
- E. injunctive or declaratory relief;
- F. any amount that is not insurable under any applicable law; or
- G. plaintiff's attorneys fees associated with any of the above.

5. No coverage for intentional / fraudulent claims

- Definition of a "claim" specifically excepts such acts

Typical Language

Claim means an oral or written demand received by the **Insured** for money or services, including a demand alleging **personal injury**, arising out of an act or omission in the rendering of **professional real estate services**. The service of suit or the institution of an arbitration proceeding against the **Insured** will be considered a demand. Except as respects an **innocent insured**, a **claim**, other than a **claim** for **personal injury**, cannot arise for intentionally wrongful, dishonest, fraudulent, malicious, or criminal conduct committed by an **Insured** or at an **Insured's** direction or with the **Insured's** prior knowledge.

D. What to Do to Protect Yourself in Light of Exclusions / Limitations

1. THINGS TO BE PREPARED FOR:

A. Intentional Actions / Fraud - you will not be covered for this

B. Major Issue - Liability Assumed Under Oral or Written Agreement

- many instances, your relationship with the lender is defined by the Broker Agreement, under which, perhaps without realization, you are assuming liability

Typical Language Under Broker Agreement

.....The Broker represents and warrants that each loan application and loan package submitted to Lender for review, including all borrower information and other data and materials contained therein, is true and correct, contains no untrue statements, does not omit any facts or information necessary to make the statements or information submitted not misleading, is accurate, and reveals any relevant facts and information. Relevant facts and information include, but are not limited to, income, reasonableness of income, assets, funds on deposit, occupancy intentions/status, and employment of the borrower; property valuation/appraisal, good and marketable title as represented by the preliminary title report, and other supporting loan package documentation. Broker understands that by making the warranty contained in this subparagraph that it is warranting that it has diligently verified the accuracy and completeness of all information submitted in support of the Loan(@ being sought from Lender, and that all such submitted information is true and correct.

.....Broker represents and warrants that there is no circumstance, condition, or event that will or may cause a Borrower to default, or that will cause secondary market investors, agencies or insuring entities to consider a loan to be an unacceptable investment.

.....**Representations and warranties True at Closing.** The representations and warranties made by Broker under this Agreement shall be true, accurate, and complete in all respects at all relevant times, including but not limited to the date(s) any Loan is funded by Lender and the Loan transaction closes. Broker shall immediately give notice to lender in writing before closing if broker discovers, or has reason to suspect, that any of its representations or warranties may no longer be true, accurate, or complete.

..... **Insurance.** Broker shall maintain policies of comprehensive general liability insurance, errors and omissions insurance, fidelity bond or other insurance typically maintained by prudent mortgage brokers in the industry. Broker shall indemnify and hold Lender harmless from and against any and all claims, demands or causes of action related to the performance of Broker's activities as contemplated by this Agreement.

.....**Indemnification.** Broker shall indemnify and hold Lender harmless from and against, and at Lender's option, defend, all claims, losses, expenses, and damages incurred or suffered, or to be suffered, by Lender including without limitation, claims, damages, losses, and expenses incurred in connection with the sale or repurchase by Lender of a Loan or as a result or arising out of: (a) any breach of Broker's representations, warranties, or covenants or (b) Broker's non performance of its obligations under this Agreement. In addition, the broker will repay Lender the yield spread premium and any premium pricing above par (100% of the original loan amount). For example, if the original loan funded at 103, including the yield spread premium, the Broker would be required to pay Lender 3% or the entire premium above par paid to broker by Lender at close of said transaction. The foregoing indemnification obligations include, but are not limited to attorneys' fees and costs and subsequent re-selling costs.

.....**Governing Law and Forum Selection.** This Agreement shall be deemed to have been entered into in _____ County, _____, regardless of where the last signature was affixed. All questions regarding its validity, enforceability, interpretation and/or performance as well as the rights and obligations of the parties hereto shall be governed by _____ law (other than its conflict of laws principles). Any action arising out of this Agreement shall, at Lender's election, only be initiated in a **court** of competent jurisdiction in _____ County, _____ and thereafter, if necessary, the appropriate appellate court therefore.

..... **Attorneys' Fees.** If any legal action, arbitration, or other proceeding is brought for the enforcement of this Agreement or because of any dispute, breach, default or misrepresentation in connection with any provision of this Agreement, the prevailing party shall be entitled to recover reasonable attorneys' fees and other costs incurred in the action or proceeding, in addition to any other relief which may be granted.

.....**Electronic Signature** (In the event that the parties execute this Agreement electronically, the following shall be in effect): By submitting this online registration, I, as a duly authorized officer of Broker, acknowledge that I have reviewed the foregoing Agreement and agree, for and on behalf of Broker, to be bound by the terms and conditions set forth in this Agreement if [LENDER] accepts the request of Broker to become an approved "Broker" hereunder. I understand that [LENDER] will notify me electronically if my application to become an approved Broker is accepted, and that this Agreement shall become binding on Broker effective on and as of the date of such notice by [LENDER].

.....I understand that this agreement imposes certain contractual duties and obligations upon Broker.

.....I understand that [LENDER] will conduct a background check that may require accessing certain personal and/or business credit and other information regarding Broker. By submitting this registration, I, on behalf of Broker, authorize [LENDER] to obtain such information.

.....I further represent and warrant that I am a duly authorized officer of Broker and I have been properly authorized by Broker to accept, consent to, and electronically execute and deliver this Agreement for and on behalf of Broker and, by doing so, I hereby make this agreement a legal, valid, binding and enforceable obligation of Broker.

C. Reservation of Rights Letter

2. WHAT YOU CAN DO

1. with respect to agreement with Lender
 - negotiate language
 - clarify duties v. liabilities

2. with respect to terms of insurance policy
 - confirm carrier knows nature of relationship with Lender
 - talk to your broker - show agreement to insurance agent, have them negotiate with carrier

3. with respect to ROR letter / protection of own interests
 - protection of non-insured interests

V. HOW TO PROTECT YOURSELF FROM FRAUDULENT ACTS OF OTHERS

A. Bad Appraiser - “Not our responsibility” may not suffice in litigation setting

1. Steps to Take with Appraiser

- a. document relationship
- b. indemnification
- c. document any communications

2. Steps to Take with Lender - liability for bad appraiser

- a. negotiate if you can
- b. duty to confirm license - clarify specifically any other duties
- c. lender involvement in process - final approval

B. Bad Borrower - Protecting yourself

1. agreement with the borrower - protective language

2. documentation - your job typically is to make sure information is accurate, but savvy borrower can sometimes fool broker. Have the borrower document EVERYTHING, not just sign, but acknowledge.

3. Negotiate if you can with lender

4. Have appraiser identify where he obtained all of his information

VI. PROTECTING YOURSELF FROM ONEROUS E-CONTRACTS

1. Watch out - these are generally enforceable - know what you are getting into and what impact it could have on coverage

2. Negotiate if you can - language cited above can cause major problems with coverage and liability

3. Try to do it with hard copy, not e-mail click agreement - some specific things can be negotiated, so try to included all that you can

VII. PROTECTING YOURSELF THROUGH RECORD KEEPING / STORAGE

1. Electronic Stored Information - Primer on new federal rules - **See attached.**

- need systematic, consistent and proactive approach to identification, preservation and disclosure of electronically-stored information (ESI)

2.. Keep information searchable

- a. per lender
- b. per borrower
- c. per appraiser
- d. per title company
- e. per broker / processor

3. Keep all broker agreements in central locations

VIII. PROTECTING YOURSELF THROUGH GOOD REPRESENTATION

1. Role of carrier's lawyer
2. Where separate interests may need to be protected, even in carrier involved
3. Settlement pressures and recommendations
4. Proactive measures

IX. POSSIBLE DEFENSE APPROACHES AFTER A LAWSUIT IS FILED

A. Claims By Lenders

1. *Contract Defenses*

A. Is the Contract Valid and Enforceable?

- a. Is it signed? Is it an e-signature? - May need discovery to sort through these issues.
- b. Does it apply to this situation?
- c. Is there an Arbitration Provision?
- d. Is there a jurisdictional advantage?

B. Has lender fulfilled its duty under the contract?

- C. Who has final call on approval/funding under terms of contract?
- D. What damages can be proven?

2. *Negligence / Breach of Standard Defenses*

a. Examine lender's Fannie Mae obligations - they are still final call on approval, unless broker has funding powers.

b. Look at Desktop Underwriters - what else should lender have done? What red flags are introduced via DU?

1. Can take the depositions of their underwriters, secure their documents.
2. If bad appraisal, what steps did lender take to ensure accuracy?
3. If credit risk, what steps were taken by lender beyond simply raising interest rates?
4. Is increasing the interest rate sufficient to obviate the need for due diligence?

c. Expert opinions may need to be secured.

d. Could local representative have done anything?

e. What damages can be proven?

3. *Fraud / Misrepresentation Defenses*

- a. Unless broker actively involved in misrepresentation and/or fraud - examine what steps lender took or should have taken to uncover the truth. If broker should have found it, what responsibility did lender have?
- b. Would lender have done anything differently had accurate information provided? It becomes a causation issue.

B. Claims by Borrowers

1. Negligence / Breach of Standard Claims

- a. Look to comparative negligence - was borrower negligent in providing information?
- b. Look to causation issues.
- c. Look to damages.
- d. May need expert opinion.

2. Defenses under Brokerage Agreement with Borrower

- a. limitation of liability clauses
- b. arbitration provisions

X. RECENT COURT DECISIONS OF NOTE

Hawthorne v. American Mortgage Inc., 489 F. Supp. 2d 480 (E.D.Pa., 2007).

In the U.S. District Court for the Eastern District of Pennsylvania, plaintiffs, purchasers, sued defendants, a mortgage broker and a lender and alleged breach of contract, fraud, violations of Pennsylvania's Unfair Trade Practices and Consumer Protection Law, and negligent misrepresentation. The parties cross moved for summary judgment. The lender worked with the broker to finance the purchasers' home of their dreams. The purchasers alleged that they lost the opportunity to purchase the home after the broker, who had promised the purchasers that the lender would provide mortgage financing on the day of closing, failed to even show up at the closing. Because the court determined that there was no genuine issue of material fact that the broker was not acting as the lender's agent in its role as mortgage broker for the purchasers, none of the broker's conduct could be attributed to the lender. The question was whether the broker exercised apparent authority to bind the lender to a contract with the purchasers. The Court found it was undisputed that the broker was free to shop the loan application, just as an insurance broker was free to shop an insured's application to different insurers. But the analogy of mortgage broker cases to insurance broker cases did not help the purchasers because if mortgage brokers were like insurance brokers, as the purchasers suggested, they were the agents of the mortgagors and not the mortgagees. Finally, the purchasers' theories of agency by estoppel and agency by ratification did not apply. The lender's motion for summary judgment was granted and judgment entered in its favor. The purchasers' motion for summary judgment against the broker was denied.

Glauser v. Deutsche Bank Nat'l Trust Co., 365 B.R. 531 (2007).

Plaintiffs, a bankruptcy debtor and her husband (mortgagors), brought an adversary proceeding against defendant mortgage lender, alleging that the lender charged an excessive, and thus unreasonable, title insurance rate which the lender failed to disclose as part of the finance charge as required by the Truth in Lending Act. The bankruptcy court conducted a trial. The mortgagors contended that the loan from the lender in part refinanced a prior mortgage debt, and the lender improperly charged the basic rate for title insurance rather than the lower refinance rate. The mortgagors thus argued that the lender was required to disclose the unreasonable rate, and that the lender's failure to make such disclosure warranted rescission of the loan. The bankruptcy court held, however, that the title insurance rate charged by the lender was not shown to be unreasonable or that the finance charge disclosed by the lender was inaccurate. There was no credible evidence that the mortgagors notified the lender of the existence of prior insurance, the lender's knowledge that the mortgagors had a prior mortgage loan did not place the lender on notice of such prior insurance, and the lender had no duty to inquire concerning prior insurance. Further, the refinance rate was not only unavailable to the mortgagors based on the lender's lack of knowledge of prior insurance, but also because the prior policy placed in evidence failed to identify the property to indicate that the policy covered the same property as the policy obtained for the new loan. Here, the bankruptcy court's verdict was that judgment was entered in favor of the lender.

Cooley v. Wachovia Mortg. Co., 365 B.R. 464(2007).

Here, defendants, trustee and successor in interest to defendant mortgage lender, moved to dismiss plaintiff debtor's two-count complaint in bankruptcy court. Count I asserted a claim against defendants for rescission and related damages under the Truth-in-Lending Act (TILA), 15 U.S.C.S. § 1601 et seq. Count II alleged a claim for damages, solely against the servicer, under the Real Estate Settlement Practices Act (RESPA), 12 U.S.C.S. § 2601 et seq. Here, the defendants' motion's major thrust was that debtor's claims should be dismissed based on the Rooker-Feldman doctrine because a mortgage foreclosure judgment was entered against him in state court. The bankruptcy court here stated that, under the facts, either claim could only be barred by Rooker-Feldman if the claims were "inextricably intertwined" with the state court adjudication. As for Count I, the conclusion that debtor's claim for rescission would have had the effect of undermining the foreclosure judgment was the death knell to his claim. His TILA claim for rescission in Count I was inextricably intertwined with the state court adjudication and was, therefore, barred by Rooker-Feldman. As for Count II, since debtor could not bring a counterclaim under RESPA in the mortgage foreclosure action, an award of damages on his RESPA claim would not have negated the foreclosure judgment. Thus, Count II was not inextricably intertwined with the foreclosure judgment and was not barred by Rooker-Feldman. Accepting the allegations of the complaint as true and viewing them in the light most favorable to debtor, Count II stated a claim that the current holder violated its obligation under 12 U.S.C.S. § 2605(e). The bankruptcy court here held that the Motion was granted in part. Count I was dismissed. Count II was not dismissed.

Escher, et al. v. Decision One Mortgage Company, et al., 369 B. R. 862 (E. D. Pa. Bk.Ct. 2007).

Plaintiffs, debtor and his wife, filed suit against defendants, an original mortgage lender, a nominee that assisted in assignment and recording, the servicer, and a mortgage management company. Their complaint sought rescission of the mortgage loan, and raised claims under federal and state consumer lending law. The original lender and the servicer/nominee filed Motions for Summary Judgment as to all of the claims. The Complaint pleaded four counts: Count I--the Truth in Lending Act (TILA), 15 U.S.C.S. § 1601 et seq.; Count II (abandoned); Count III--the Pennsylvania Credit Services Act (CSA), 73 Pa. Stat. Ann. § 2181 et seq., and the Pennsylvania Loan Brokers Trade Practices Regulations (LBTPR), 37 Pa. Code § 305.1 et seq.; and Count IV--the Pennsylvania Uniform Trades Practices and Consumer Protection Law (UDAP), 73 Pa. Stat. Ann. § 201-1 et seq. Count I was directed at the original lender, the servicer and the nominee. Count III was limited to the mortgage management company. Count IV was directed against all defendants. Because the record demonstrated that the yield spread premium and title insurance charges were disclosed in accordance with TILA, Count I had to be dismissed. Plaintiffs were no longer pressing the claims in Count III against either the original lender or the servicer. Finally, the claim of UDAP liability derived from the TILA, CSA, and LBTPR claims. Those claims having been found to have been either abandoned or unsupported as to the moving parties, the UDAP claim likewise necessarily had to be dismissed as to them. Summary judgment was granted in favor of the moving defendants as to all four counts of the Complaint.

Fish v. Pa. Housing Fin. Agency, 931 A.2d 764 (Pa. Cmwlt. 2007).

Petitioner, applicant, petitioned for review of an order of respondent Pennsylvania Housing Finance Agency, which denied his application for emergency mortgage assistance under the Homeowner's Emergency Mortgage Assistance Loan Program (HEMALP), 35 Pa. Stat. Ann. §§ 1680.401c-1680.410c. On appeal to the Commonwealth Court, the applicant argued that the Agency failed to address whether his HEMALP loan was declined due to a \$ 22,972 defect in the HEMALP notice, and that a new HEMALP notice was required after the prior foreclosure action was withdrawn. The appellate court found that the applicant was denied the loan due to the fact that he was not suffering financial hardship. Thus, the applicant's claim that he did not know which amount the Agency denied was irrelevant, as he would be suffering less of a financial hardship if the defect in the notice was taken into consideration. In addition, the applicant received the HEMALP notice, which provided him with alternatives, the time in which he needed to accomplish such acts, and the consequences for failing to accomplish the acts. The applicant failed to comply with the procedural requirements of the HEMALP. Even though the lender's first foreclosure action was withdrawn, it did not follow that the notice had to be withdrawn because the notice merely placed a mortgagor on notice that if he did nothing, a foreclosure action would follow. Pursuant to 35 Pa. Stat. Ann. § 1680.403c(d), the lender was not required to send any additional notice. The Agency's order was affirmed by the Commonwealth Court.

(Piercing the Corporate Veil)

Fletcher-Harlee Corporation v. David Concrete Corporation, Inc., 936 A.2d 87 (Pa. Super. 2007).

Appellee David Szymanski was the sole shareholder, director, and officer of several corporations. One such corporation was “Delmarva Concrete, Inc.” Appellant, Fletcher-Harlee Corporation, was a general contractor for the construction of an elementary school. The concrete work for the project was subcontracted to Delmarva. Subsequently, a dispute arose between appellant and Delmarva. Appellant was awarded a verdict by the American Arbitration Association in relation to such dispute. Delmarva then ceased doing business and eventually filed for bankruptcy, primarily due to this judgment. Mr. Szymanski, however, remained in the concrete business, performing jobs through “Del Concrete, Inc.” Mr. Szymanski was the sole shareholder, director, and officer of this corporation as well. In April 2004, Appellant filed a complaint against Szymanski and Del Concrete, seeking to pierce Delmarva’s corporate veil in order to hold the various defendants liable for the judgement that appellant had obtained against Delmarva. The Court noted that “there appears to be no clear test or well settled rule in Pennsylvania...as to when the corporate veil can be pierced and when it may not be pierced.” Further, in deciding whether to pierce the corporate veil, courts are basically concerned with determining if equity requires that the shareholders’ traditional insulation from personal liability be disregarded and with ascertaining if the corporate form is a sham, constituting a facade for the operations of the dominant shareholder. The Court held that it was clear that Delmarva was not adequately capitalized, as when faced with the arbitration judgment, it filed for bankruptcy. Further, the Court found that Delmarva failed to adhere to corporate formalities. Specifically, Mr. Szymanski commingled his corporate and personal affairs. Thus, the Court held that equity required that Mr. Szymanski be held liable for the judgment.

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E-DISCOVERY AMENDMENTS TO FEDERAL RULES OF CIVIL PROCEDURE

On December 1, 2006, new amendments to the Federal Rules of Civil Procedure will take effect to specifically address the unique challenges of electronic discovery. The amendments will modify the existing rules in a manner intended to further highlight the importance of and provide a more established frame work regarding electronic discovery. Obviously, the unanswered question involving the procedural and operational adjustments concerning insurance companies and other organizations is wide spread. The likely impact of the amendments involve both intangible affects and more concrete operational changes. Specifically, the amendment to Rule 26(a)(1)(B) requires the initial disclosure of copies, or description by category and location, of all electronically stored information (“ESI”). Rule 26(b)(2)(B) limits the disclosure of ESI from sources that the producing party identifies as not reasonably accessible because of undue burden or cost. In addition, the Rule 26(f) conference must also address any issues relating to disclosure of discovery of ESI, including the form or forms in which ESI should be produced.

Other ESI rule changes involve Rule 33(d), which allows a party answering interrogatories to indicate that the answer to a specific interrogatory can be gleamed from ESI. Rule 34, pertaining to document production, permits a party to produce any ESI, including, writings, drawings, graphs, charts, photographs, sound recordings, images, and other data or data compilations stored in any medium from which information can be obtained. Rule 34(b) permits the requesting party to request the ESI in a specific form. In responding to

the Request for Production, the responding party must produce the ESI in the form requested, unless the party obtains a protective order. If the requesting party does not specify the form of the ESI production, the responding party must produce the ESI as it is ordinarily maintained or in a form or forms that are reasonably usable. A party need not produce the same electronically stored information in more than one form.

Lastly, Rule 37, pertaining to sanctions, has also been amended to address the ESI issue. Specifically, Absent exceptional circumstances, a court may not impose sanctions under these rules on a party for failing to provide ESI lost as a result of the routine, good-faith operation of an electronic information system. Otherwise, ESI is treated as any other form of documents.

The ESI concept has already permeated the vernacular of judges and legal pundits. Consistent and uniform terminology will result in a more uniform approach by the Courts to ESI discovery. The new amendments send a clear message of standardization and inevitability surrounding ESI discovery. Everyone is now on notice, and any uncertainty regarding the overall importance of ESI, is removed. As such, ESI discovery practice will only increase and will become part of almost all federal civil litigation.

In terms of a more specific operational impact, a consistent theme throughout the amendments is one of *de facto* requirement for large organizations to adopt a systemized internal process to address inevitable ESI discovery. This theme of systemization is steeped in three key elements of the amendments: the early attention requirements, the native file production requirement for ESI, and the safe harbor rule for deleted data in the normal course of business.

One of the most important aspects of the pending amendments is that they direct attention to electronic discovery issues early in a litigation process. For instance, the amended rules require that relevant or electronic evidence be identified, preserved and disclosed at the initial outset of the litigation. As noted by the judicial conference in the September 2005 comments: “the proposed amendments present a frame work for the parties and the court to give early attention issues relating to electronic discovery including the frequently recurring problem of the preservation of the evidence.”

The preservation element is particularly critical. Courts are increasingly holding parties to a stricter standard concerning the preservation of ESI and the amendments and their corresponding comments strongly emphasize the important duty to properly preserve ESI. The comments to Rule 26(f) note: “the volume and dynamic nature of electronically stored information may complicate preservation obligations...failure to address preservation issues early in the litigation increases uncertainty and raises a risk of dispute.” As such, under these new rules, litigants will face a much higher likelihood of court sanctions if they fail to properly preserve relevant ESI at the outset of litigation.

In order to properly identify, preserve and disclose relevant ESI, large companies are establishing a highly operational and systemized process to address ESI requirements as a standard litigation practice with each case instead of a more reactive and *ad hoc* approach. The traditional “wait and see” approach to ESI discovery - or company and their counsel often defer addressing ESI until its production is demanded by their opponent - results in a disjointed approach to ESI typified by hurried out sourcing of other non systemized collection and preservation efforts that greatly increase costs and risk. However, such

practices are no longer sustainable under this new framework. Only with an integrated systemized and efficient internal process to routinely identify and preserve relevant ESI at the outset of each case will organizations be able to establish reasonableness in the eyes of the court.

Another key systemization element of the amendments involves the provisions for the production of ESI. Rule 34(b) is amended to supply a procedure for specifying and objecting to the form of production of ESI. Under new subsections 34(b)(ii) and 34(b)(iii), the default form for production of electronically stored information is that “in which it is ordinarily maintained or reasonably usable.” It is widely expected that parties will request that ESI be produced in native file format which is generally how the data is ordinarily maintained and is the most usable format.

Additionally, numerous recent decisions hold that file metadata contained within ESI must also be preserved and produced. See *Nova Measuring Instruments, Ltd., v. Nano Metrics, Inc.*, 417 F.Supp. 2d 1121 (N.D. CAL. 2006). (Upholding discovery orders requiring production of documents in native format with metadata is not clearly erroneous). While ESI discovery is out-sourced and not systemized, it is difficult to properly preserve and produce ESI in its native format with its metadata intact.

Finally, the safe harbor rules are also a key systemization element of the new amendments. Subsection 37(f) is added which states, in full, “absent exceptional circumstances, a court may not impose sanctions under these rules on a party for failing to provide electronically stored information lost as a result of routine, good faith operation of electronic information system.” The advisory committee notes explained that ordinary computer use necessarily

involves routine alteration and deletion of information for reasons unrelated to litigation.

However, in order for a party to establish that deletion of ESI resulted from their routine and good faith operation of their electronic information system, the party must be able to demonstrate the existence of an established well documented and systemized electronic records management process. This process must be effectively tied into the parties litigation readiness plan, so that litigation holds are effectively executed. Again, this is impossible without a well planned and established system wide process. As with each of the elements of the new rules discussed above, the more established and systemized the process to preserve, collect and delete ESI, the more reasonable and defensible the process will be seen in the eyes of the court.

The traditional and non-systemized approach to electronic evidence discovery involves a highly manual process to gather immense sums of data and then load that data onto a system that allows for searching and processing. This approach results in ever increasing costs as the volume of data in a corporation grows. For instance, without enterprise computer investigation technology, collecting files from hundred or even thousand of computers distributed across multiple locations must be performed manually. With no means to triage and filter out irrelevant data, the collection was a little broad, with a great deal of irrelevant data aggregated into a central data base where it is then finally processed and searched. Metadata is lost in the process and files are migrated into non-native format. Establishing a defending process is a critical element of compliance as opposing counsel are now routinely seeking to capitalize on an E discovery struggles of large companies.

Lawyers in particular seek to distract the defense with “litigation within litigation” allegations of spoliation or lack of due diligence in complying with E discovery requests. Plaintiffs seek to gain a significant advantage of obtaining evidentiary sanctions, petitioning the court for an order allowing their own experts to investigate the corporate defendant systems or otherwise driving up the cause of litigation by forcing costly and over broad computer evidence investigation. With the new Federal Rules frame work, these tactics are only going to increase.

In the end, companies will need the assistance of counsel to implement guidelines and monitor ESI so that large volumes of data can be retained when necessary, deleted when appropriate, and produced when required.

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