Client Advisory

KELLEY DRYE

CONSUMER FINANCIAL SERVICES PRACTICE GROUP FEBRUARY 2008

LaSalle Bank v. Shearon
A Harbinger of Things to Come:
New York Supreme Court Rules in Favor of Borrower on Defensive Claims Under State's Anti-Predatory Lending Law

Introduction

In an opinion that may well mark a rise in predatory lending claims and an expansion in the scope of lender liability, the New York Supreme Court recently found in favor of a homeowner who, in defending a motion for summary judgment in a foreclosure action, alleged that he was the victim of predatory lending practices prohibited by New York Banking Law §6-L. The court, in *LaSalle Bank, N.A. v. Shearon,* No. 100255/2007, 2008 WL 268449 (N.Y. Sup. Jan. 28, 2008), denied LaSalle's motion and granted summary judgment for the homeowner based on his defenses under the state's anti-predatory lending law. A hearing on damages is pending.

Why *Shearon* Matters

The court's decision in *Shearon* is noteworthy for several reasons:

May enable homeowners facing foreclosure to turn the tables on lenders: The number of homeowners facing foreclosure and/or bankruptcy is going through the roof. *See* Joel E. Hewer, Donna L. Wilson, "Working Through The Workout Boom," *Banking Law Journal*, December 2007. With decisions like *Shearon*, more and more consumers (and their lawyers) may use anti-predatory lending laws to stave off foreclosure. The impact on loan originators and their successors in interest may be significant, given the penalties, such as rescission, that may be available to the homeowner.

An Invitation to Borrowers to Pursue Predatory Lending Claims: The court's stand may well embolden homeowners, and of equal importance, counsel, to more aggressively pursue enforcement of anti-predatory lending laws. It's no secret that subprime-related cases, many of them initiated by borrowers, are on the rise.

Liability Extended to Successors in Interest: The plaintiff in this action, LaSalle Bank, was not involved in the original mortgage transaction. Rather LaSalle was the trustee and successor to the original lender. Still, by virtue of its subsequent control of the loan, the *Shearon* court found LaSalle liable for the alleged actions of the original lender. The court's decision underscores that loan originators and successor loan holders alike have liability risk for alleged predatory lending practices. Since mortgages, and particularly subprime loans, are often packaged, sold, and resold before the final loan holder eventually brings a foreclosure action or is targeted by bor-

rowers, under *Shearon* the expansion of liability to secondary actors is significant, particularly given the scope of relief available to the borrower.

The Details

In 2005, Staten Island couple David and Karen Shearon were preparing to purchase their first home. David's credit score was 696. Karen's credit score was 760. Their combined annual income was less than $30,000. Relying on assurances from their mortgage broker that they would qualify for traditional mortgage loan products with fixed rates and that the broker would shop around for the "best rates", the Shearons found a house and applied for financing as husband and wife. They put $5,000 down on a property under a contract of sale for a purchase price of $335,000, with a seller's concession of $20,100.

The sale was ultimately financed at $355,000, with two loans, one for $284,000 with a fixed-to-adjustable rate feature, and a second for $71,000 at a fixed rate in excess of 10%. Both loans were closed in David Shearon's name only. Total points and fees financed on the combined loans was approximately 5.4% of the total amount borrowed. The loans were made by WMC Mortgage Corporation, with LaSalle Bank listed as the trustee and successor to both. Less than two years after closing, when the Shearons failed to make monthly payments on the loans, LaSalle brought a foreclosure action against Mr. Shearon.

In defense of the foreclosure action, Shearon argued that he was the victim of predatory lending practices, alleging:

1) Excessive financing was provided to permit the financing of points, broker fees, and costs;
2) The lender's due diligence regarding Shearon's ability to repay was inadequate;
3) The lender intentionally placed Shearon into subprime loans, to the benefit of the lender, in the form of excessively high interest rates, extended loan terms, and inflexible refinancing;
4) Disclosures mandated by federal and state laws were not adequately provided;
5) Certain loan documents were forged; and
6) The lender repeatedly employed coercive tactics.

Shearon argued that each of these separate actions violated New York Banking Law §6-L, which governs "high cost loans." The statute defines "high cost loan" to include a first or second lien mortgage loan with an interest rate or points and fees in excess of specifically identified caps, and places obligations on high cost lenders, including: (i) prohibiting financing points and fees in excess of 3% of the total loan amount; (ii) requiring lenders to provide prescribed disclosures, including information on financial counseling; and, (iii) requiring lenders to refrain from lending without verifying application information and giving due regard to the applicants' ability to repay.

The lender (or more accurately here, LaSalle Bank, as the successor-in-interest to the original lender, WMC Mortgage) argued that the loans issued to Shearon did not exceed the statutory rate that would qualify them as high cost loans under the New York statute. The court disagreed, viewing the loans together and reasoning that WMC must have considered the loans to be "high cost," given that it

documented them using high cost loan forms. The court then went on to identify possible remedies under the statute, including rendering the loan(s) void, stripping the lender of any right to collect any principal, interest, or other charges, and requiring the lender to disgorge any payments already made by the borrower.

Focusing it attention on WMC's actions, the court then concluded that WMC violated §6-L when placing the loans. Specifically, the court held that WMC financed fees and points associated with the loan in access of the permissible cap and that it failed to make sufficient inquiries as to the truth of the financial information provided by the borrower or the ability of the borrower to repay the loan. In addition, the court found that WMC failed to make required disclosures under the New York statute, including providing a list of credit counselors. Having found these violations, the court noted that the remedy provision of the statute had been triggered and scheduled a hearing for February 28, 2008, to determine the extent of the award, with LaSalle Bank, as successor in interest on the loans, at risk of being penalized for the actions of WMC.

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