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Housing Initiative Clinic Briefs

Jesinoski and the Homeowner's Right to Rescind under the Truth in Lending Act

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This Housing Initiative Clinic Brief reviews the impact that the Supreme Court's decision in *Jesinoski v. Countrywide Home Loans, Inc.*, 135 S. Ct. 790 (2015), will have on a borrower's right to rescind a second mortgage under the Truth in Lending Act.

Overview

In the aftermath of the Financial Crisis of 2008, millions of Americans lost their homes, and still more held second mortgages on which the amount of outstanding debt exceeded the value of the home. Unsurprisingly, many borrowers looked for ways to discharge their loans when faced with foreclosure. One avenue that borrowers pursued was rescission of the loan under the Truth in Lending Act ("TILA").[1] Under TILA, borrowers can rescind loans used to refinance their home mortgages so long as the borrower rescinds the loan within three years of taking it out, the borrower shows that the lender failed to provide certain disclosures required by TILA, and the loan in question is secured by the borrower's home.[2] Unsurprisingly, many borrowers purported to rescind their loans by sending letters to their lenders stating that they had not received the required TILA disclosures, and were rescinding their loans; many lenders simply ignored the letters.[3] Some borrowers filed suits to rescind the loans.

[1] Ronald Mann, Argument Analysis: It May Take 'Houdini' Himself for Lenders to Escape with Victory in TILA Rescission Dispute, SCOTUS Blog (November 5, 2014, 3:38 PM), http://www.scotusblog.com/2014/11/argument-analysis-it-may-take-houdini-himself-for-lenders-to-escape-with-victory-in-tila-rescission-dispute/.
[2] 15 U.S.C.S. § 1635 (a) (LexisNexis 2015).
[3] Mann, supra.

The question before the Supreme Court in *Jesinoski v. Countrywide Home Loans* ("*Jesinoski*") was whether the letters in which borrowers stated that they were rescinding their loans were an exercise of the right to rescind under TILA, or whether a court filing was required. That question was of significant import because often, borrowers would send letters to lenders purporting to rescind their loans within three years of receiving the loan, but would not file suit until TILA's three-year time limit for rescinding of loans had expired. In *Jesinoski*, the Court unanimously held that a borrower sending a letter to the lender, stating an intent to rescind, was sufficient to rescind under TILA.[4] This will lead to rescission of TILA loans in more cases.

The Truth in Lending Act and the Pre-*Jesinoski* Case Law

As Justice Scalia noted in *Jesinoski*, "Congress passed the Truth in Lending Act, 82 Stat. 146, as amended, to help consumers 'avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing.'"[5] Therefore, TILA imposes two key layers of consumer protection on loans that are secured by the borrower's "primary dwelling." First, borrowers have the unconditional right to rescind the loan within three business days.[6] Second, lenders are required to disclose pertinent information about the terms of the loan. If the lenders fail to make all of the required disclosures upon consummation of the loan, the borrower may rescind the loan until the time at which the lender makes the required disclosures; this right to rescind expires three years after consummation of the loan, even if the lender never makes the required disclosures.[7]

[4] See Jesinoski v. Countrywide Home Loans, Inc., 135 S. Ct. 790 (2015).
[5] Jesinoski, 135 S. Ct. at 792.
[6] 15 U.S.C.S. § 1635 (a).
[7] Id.; 15 U.S.C.S. § 1635 (f) (LexisNexis 2016).

While TILA grants a right to rescind to qualifying borrowers, there are three key restrictions on which loans may trigger the right to rescind. First, and most significantly, the right to rescind does not apply to a "residential mortgage transaction."[8] A residential mortgage transaction is a transaction in which a loan is used "to finance the acquisition or initial construction" of a person's house.[9] Thus, the right to rescind applies only to a second mortgage loan, or to a refinancing of a home mortgage. Second, the right to rescind only applies to a loan secured by the consumer's "principal dwelling," as opposed to a second home.[10] Finally, a mortgage refinancing with the lender who issued the original mortgage loan cannot be rescinded under TILA.[11]

If a loan qualifies for the TILA right to rescind, the borrower still must exercise his or her right to rescind in accordance with the procedures specified in TILA. Specifically, TILA provides that "the obligor shall have the right to rescind . . . by notifying the creditor, in accordance with regulations of the Board, of his intention to do so."[12] The language of TILA thus does not seem to require a court filing to exercise rescission. Regulation Z (12 C.F.R. § 226.23), the regulation that implements TILA, supports the notion that a court filing is not required. Regulation Z states that, "[t]o exercise the right to rescind, the consumer shall notify the creditor of the rescission by mail, telegram or other means of written communication. Notice is considered given when mailed, when filed for telegraphic transmission or, if sent by other means, when delivered to the creditor's designated place of business."[13]

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[8] 15 U.S.C.S. § 1635 (e)(1) (LexisNexis 2016).
[9] 15 U.S.C.S. § 1602 (x) (LexisNexis 2016).
[10] 15 U.S.C.S. § 1635 (a).
[11] 15 U.S.C.S. § 1635 (e)(2) (LexisNexis 2016).
[12] 15 U.S.C.S. § 1635 (a).
[13] Regulation Z, 12 C.F.R. § 226.23 (a)(2) (LexisNexis 2016).

A majority of the pre-*Jesinoski* case law held that notice of intent to rescind was not sufficient to defeat the three-year time bar. Rather, most courts found that a court filing was necessary, though the United States Court of Appeals for the Third Circuit, as well as the Fourth Circuit, held that notice of intent to rescind was all that was required.[14] The *Jesinoski* case came up through the Eighth Circuit, which followed the majority approach that notice of intent to rescind was not sufficient to defeat the three-year time bar.[15]

Jesinoski v. Countrywide

The Supreme Court unanimously reversed the decision of the Eighth Circuit in a short opinion by Justice Scalia. The Court began its analysis by looking at the text Section 1635(a). As the Court noted, "Section 1635(a) explains in unequivocal terms how the right to rescind is to be exercised: It provides that a borrower 'shall have the right to rescind . . . *by notifying the creditor, in accordance with regulations of the Board, of his intention to do so*' (emphasis added)."[16] Justice Scalia explained that "the language leaves no doubt that rescission is effected when the borrower notifies the creditor of his intention to rescind… The statute does not also require him to sue within three years."[17] The Court then addressed the arguments made by Countrywide and the Eighth Circuit.

First, the Court explained that its decision in *Beach v. Ocwen Fed. Bank*, 523 U.S. 410 (1998)

[14] See Sherzer v. Homestar Mortgage Services, 707 F.3d 255 (3d Cir. 2013); Gilbert v. Residential Funding LLC, 678 F.3d 271, 276 (4th Cir. 2012).
[15] Jesinoski v. Countrywide Home Loans, Inc., 729 F.3d 1092 (8th Cir. 2013).
[16] Jesinoski, 135 S. Ct. at 792.
[17] Id.

(which was relied upon by the Eighth Circuit) was irrelevant to whether filing a suit was necessary to obtain rescission; rather the *Beach* opinion simply stated that there was no federal right to rescind, even in a counterclaim, after the three-year period had passed.[18] Second, the Court addressed the Eighth Circuit's argument that at common law, rescission was designed for remedial economy. The Court stated, "[n]othing in our jurisprudence, and no tool of statutory interpretation, requires that a congressional Act must be construed as implementing its closest common-law analogue."[19] Third, the Court evaluated an argument made by Countrywide that, "the phrase 'award relief' 'in addition to rescission' [in Section 1635(g)] confirms that rescission is a consequence of judicial action."[20] The Court dismissed this argument because, "Section 1635(g) makes clear that a court may not only award rescission and thereby relieve the borrower of his financial obligation to the lender, but may also grant any of the remedies available under §1640 (including statutory damages). It has no bearing upon whether and how borrower-rescission under §1635(a) may occur."[21] Finally, the Court dismissed a new argument made by Countrywide. The argument was that even if the right to rescission could ordinarily be exercised through written notice rather than a lawsuit, a lawsuit is required to obtain rescission when the adequacy of the disclosures given by the lender is disputed. The Court dismissed this argument because there is no textual basis for distinguishing situations when the adequacy of disclosures is disputed from other situations.[22]

The Impact of *Jesinoski*

[18] Id.
[19] Id. at 793.
[20] Id. at 792.
[21] Id.
[22] Id.

The Court's decision in *Jesinoski* may have two significant impacts. First, more borrowers will be able to seek rescission of Section 1635(a) loans, since those who gave notice of rescission prior to the expiration of the three year period (or within the three day window in which there is an unconditional right to rescission), but did not file a suit before the end of that period, will be able to seek rescission. Second, some borrowers may get their loans discharged and get to keep the property that was secured by the loan.

Under TILA, when the borrower exercises his or her right to rescind a loan, there are significant economic implications for both the borrower and the lender. When the borrower sends notice to the creditor that the borrower is rescinding the loan, the lender's security interest in the borrower's dwelling is voided.[23] The lender then has twenty days to take all actions necessary to reflect the termination of the security interest, and return any consideration the borrower paid to the lender (such as a down payment or earnest money).[24] Next, "the [borrower] shall tender the property to the [lender], except that if return of the property in kind would be impracticable or inequitable, the obligor shall tender its reasonable value."[25] Finally, if the lender fails to take possession of the property within twenty days of the borrower tendering the property to the lender, the borrower obtains title in the property and is not required to pay for it.[26]

The fact that more borrowers may seek rescission in the post-*Jesinoski* world may seem insignificant on its face because borrowers are generally required to return their property as part of the rescission process; the property is traded for the discharge of the loan. But in many cases

[23] 15 U.S.C.S. § 1635 (b) (LexisNexis 2016).
[24] Id.
[25] Id.
[26] Id.

in which rescission is sought, the amount of the loan to be discharged exceeds the value of the property to be returned. While in a foreclosure, the lender may be limited to seizing the secured property anyway (if it is a non-recourse loan), avoiding foreclosure via rescission may benefit borrowers because foreclosures are generally harmful to credit ratings.

The other major impact of *Jesinoski* is that some borrowers will be able retain their homes and discharge their loans at the same time. This is the case because under 1635(b), "if return of the property in kind would be impracticable or inequitable, the obligor shall tender its reasonable value."[27] Thus, if the borrower can demonstrate that return of the property is "impracticable or inequitable" they only have to tender "reasonable value." This scenario seems relatively likely to occur in the case in which the rescission exercised by the borrower is of a second mortgage loan agreement (or a refinancing). If a homeowner still has one mortgage to pay down (in addition to the loan to be rescinded), return of the property may be "impracticable or inequitable," since returning the property to the second lender would leave the initial lender (the one who granted the first mortgage) without any security interest. Then, if the security interest from the second mortgage is junior to the first one, the second lender is stuck rescinding their loan while not being able to collect the property secured by the loan. Further, the tender of "reasonable value" is required "even if there is no reasonable prospect that a judgment-proof borrower ever will tender the original loan amount back to the lender."[28] Thus, the borrower may theoretically owe the second lender "reasonable value," but there will be no way of collecting such value.

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[27] Id.

[28] Ronald Mann, Argument Preview: High-Powered Counsel Spar in Truth in Lending Act Timeliness Dispute, SCOTUS Blog (October 29, 2014, 8:00 AM), http://www.scotusblog.com/2014/10/argument-preview-high-powered-counsel-spar-in-truth-in-lending-act-timeliness-dispute/.