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Mortgage Lending: When Does a Borrower's Right to Rescind a Mortgage Loan under the Truth in Lending Act Expire: Jesinoski v. Countrywide Home Loans (13-684) [notes]

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Mortgage Lending: When Does a Borrower's Right to Rescind a Mortgage Loan Under the Truth in Lending Act Expire?

CASE AT A GLANCE

The Truth in Lending Act permits a borrower to rescind a loan secured by a mortgage on the borrower's principal residence by notifying to the lender within the first three days after the loan is made, or within three days of receiving loan disclosure forms if those forms are not provided at closing. This right expires three years after the loan is originated. In this case, the Court must decide whether that three-year limit refers to notifying the lender of the decision to rescind, or to filing an actual suit for rescission.

Jesinoski v. Countrywide Home Loans
Docket No. 13-684

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From: The Eighth Circuit

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INTRODUCTION

The Truth in Lending Act (TILA) requires that lenders make certain disclosures to potential borrowers to ensure that borrowers have the opportunity to understand the terms of the loan they are taking and to shop for credit with full information. Section 1635(a) of TILA provides a borrower with the right to rescind a loan secured by the borrower's principal residence before midnight on the third business day after the loan is consummated "by notifying the creditor, in accordance with regulations of the [Consumer Finance Protection] Bureau, of his intention to do so." However, to give teeth to the act's disclosure requirements, it provides that if the borrower is not provided at closing with proper disclosures and notice of the right to rescind, the deadline to rescind the transaction is extended until three days after those materials are provided.

As originally passed, TILA did not include any time limit on the borrower's right to rescind if the lender did not comply with its disclosure requirements. In 1974, however, Congress added section 1635(f), under which the right to rescind expires three years after the consummation of the loan even if the lender has never provided the required disclosures and forms. The courts of appeals have split on the effect of section 1635(f), with the Third, Fourth and Eleventh Circuits holding that it is enough if the borrower provides notice of rescission before the right expires' and the First, Sixth, Eighth, Ninth, and Tenth Circuits holding that if the lender objects to rescission, the borrower must actually bring suit within that three-year period.

The TILA rescission provisions were initially drafted with a primary focus on home improvement scams and reflect the facts of such cases rather than the mortgage loan issues that loom so large today. Section 1635(b) of TILA provides a specific sequence of events for rescission. Within 20 days after receiving a notice of rescission, the creditor must terminate its security interest in the property (the mortgage). After this is done, the borrower must tender payment of the debt to the creditor. The borrower has an absolute right to rescind within the first three days after closing or receipt of the required disclosures, and the prescribed sequence of actions fits such rescissions well.

However, TILA does not directly address the possibility that a creditor might contest the borrower's right to rescind the transaction nor explain how such disputes should be handled, giving rise to the present controversy. The statute seems to assume that every notice of intent to rescind will be justified and a rapid nonjudicial remedy is therefore appropriate. So a single set of rescission provisions essentially applies to two dramatically different situations: uncontested rescissions (whether in the first three days, or because the creditor concedes a TILA violation or otherwise consents) and contested ones. Automatic and rapid rescission is appropriate in the former case, and problematic in the latter.

ISSUE

May a borrower rescind a mortgage loan for violation of the Truth in Lending Act by sending a notice of rescission within the three-year window provided by section 1635(f) and bringing suit thereafter if the creditor objects, or must the borrower actually file suit within that three-year period?

FACTS

On February 23, 2007, Larry and Cheryle Jesinoski borrowed $611,000 from Countrywide Home Loans, Inc. to refinance their mortgage. Exactly three years later, on February 23, 2010, they mailed a letter notifying the lender that they were rescinding the loan because of violations of the Truth in Lending Act. (The alleged violation was providing the borrowers with one copy of the Truth in Lending Disclosure Statement and Notice of Right to Cancel, rather than two copies as required by the governing regulations.) The lender denied their demand to rescind the transaction, disputing whether TILA had been violated, and on February 24, 2011, the borrowers filed suit to rescind the loan and for damages for the lender's refusal to grant the rescission.

The U.S. District Court for the District of Minnesota dismissed the suit because it was filed more than three years after the consummation of the loan. The Court of Appeals for the Eighth Circuit affirmed, although two of the three judges specifically noted that they did so only because they were bound by an earlier Eighth Circuit case and that if the issue was still open in their circuit they would have ruled for the borrowers. The Jesinoskis filed a petition for certiorari, which the Supreme Court granted.

CASE ANALYSIS

The Jesinoskis, petitioners before the Court, argue that they rescinded the loan before the right of rescission expired because the right is exercised by providing notice to the creditor, which they did within the three-year period provided by section 1635(f). Respondent argues providing notice of rescission does not automatically result in rescission if the lender contests the right to rescind, and that section 1635(f) is a statute of repose requiring that any suit to rescind be filed within its three-year period.

Petitioners' argument begins with the plain meaning of the words of section 1635(a), which, they argue, unambiguously provide for rescission to be accomplished by notice: "the obligor shall have the right to rescind the transaction … by notifying the creditor, in accordance with regulations of the Bureau, of his intention to do so." Section 1635(b) specifies the further steps in the rescission process, providing that within 20 days of receipt of the notice the lender must cancel the mortgage. Once that is done, the borrower must tender repayment of the loan to the lender. This provides a simple, expeditious nonjudicial remedy for borrowers, under which rescission is accomplished by notice, rather than a judicial determination of a TILA violation.

In support, petitioners argue that section 1635 was "intended to codify long-settled principles of rescission law," under which rescission could be accomplished by providing notice of the rescission and returning any consideration to the other party. No suit was required to rescind the transaction, although a suit might have been needed after rescission to compel restitution from the other side.

According to petitioners, section 1635(f), which provides that the right to rescind "shall expire" after three years, does not change the fact that rescission is accomplished by notice, without filing suit, and does not establish any limitation on when such a suit may be filed (provided the notice is given within the three years). Petitioners contrast section 1635(f), which says that the "right of rescission shall expire," with the typical language used in a statute of limitations, which will refer to the time limit for commencing an action or filing a suit. For example, section 1640(e), which applies to suits for damages for violation of TILA, states that "any action under this section may be brought … within one year from the date of the occurrence of the violation."

Moreover, petitioners argue, TILA expressly authorized the Federal Reserve Board (and now the Consumer Financial Protection Bureau, which took over responsibility after the passage of the Dodd-Frank Act) to enact implementing regulations. Regulation Z, adopted in 1969, provides that

> to 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.

Neither the statute nor the regulations state that the borrower must bring suit in order to rescind. Petitioners argue that the interpretation of TILA embodied in these regulations is a reasonable one that is entitled to deference by the courts. Further, Congress has repeatedly amended TILA in the forty years since Reg. Z was adopted, including various amendments to the rescission provisions, without ever changing the method of rescission set forth in section 1635(a), thereby acquiescing in the Board's interpretation. In 1977, for example, Congress considered but rejected an amendment to create a cause of action "to determine the consumer's right to rescind"; in 1980 it narrowed the range of transactions in which rescission rights were available, and in 1995 it expanded the use of rescission as a defense in foreclosure proceedings. In none of these enactments, however, did Congress amend the means of rescinding (by notice to the creditor) laid out in section 1635(a) and Reg. Z.

Respondent argues that the regulations are entitled to no deference, as they are at odds with TILA's clear requirements. Further, the regulations explain what is required to provide the notice of intention to rescind under section 1635(a), but say nothing about the acts a borrower must take to obtain resolution of a contested rescission or when those acts must be taken.

Respondent agrees that TILA codifies common-law rescission but disagrees on what that means. Under TILA, the borrower has an unconditional right to rescind within three days of receiving the statutory disclosures, but rescission after that depends on whether the lender has violated TILA. Within the first three days after loan documents are executed, rescission is simple and straightforward, as laid out in sections 1635(a) and (b), particularly because loan funds are normally not disbursed to the borrower until after the three-day period has passed.

Rescission for a TILA violation, however, is "problematic" because the funds have been disbursed, mortgage recorded, and the right to rescind may be contested by the lender. If the lender contests the right to rescind, respondent argues, the steps laid out in section 1635(b) "will not take place and must be established by judicial resolution." According to respondent, TILA "prescribes a different procedure" in such cases, offering a cause of action under section 1635(g) in which a court may "award" rescission.

Section 1635(g) states, in its entirety, that "[i]n any action in which it is determined that a creditor has violated this section, in addition to rescission the court may award relief under section 1640 of this title for violation of this subchapter not relating to the right to rescind." Petitioners argue that this language acknowledges that rescission may be awarded by a court but, according to their reading, it neither creates a cause of an action for rescission nor requires that a borrower file suit in order to rescind. It simply allows a court to award both rescission and damages if an action by the borrower or a government agency results in a determination that TILA was violated.

Respondent argues that the need for a judicial proceeding in order for rescission to take effect over the lender's objection is reinforced by the common law, which recognized two means of rescission. Rescission could be effected at law by unilateral notice and tender if the other party did not contest the right to rescind. If the other party objected, however, it was necessary to bring a judicial proceeding for equitable rescission. Petitioners argue that Congress intended to mirror rescission at law, but respondent claims that the actual model was rescission at equity, as shown by (1) the separation of notice and tender, both which were required for rescission at law; and (2) section 1635(g), which provides that a court may award rescission.

Respondent argues that while section 1635(a) provides for the borrower to notify the lender of its "intention to rescind," this does not automatically result in rescission. Even under rescission at law, the notice did not effectuate rescission absent tender of the benefits received by the rescinding party (which is beyond most borrowers unless and until the mortgage is voided). The rescission itself, respondent argues, is accomplished either through the unwinding of the transaction as laid out in section 1635(b)—including return of the loan proceeds to the lender—or by an award of rescission under section 1635(g).

Under section 1635(c), if a borrower has signed an acknowledgement at closing that the required disclosures and notices were received, there is a rebuttable presumption that this is true. Such a presumption, respondent argues, has no effect outside of litigation, showing that Congress envisioned litigation to resolve contested rescission cases. Moreover, it would make no sense, in the face of this presumption, to argue that a lender is subject to automatic unilateral rescission upon notice from borrowers who, like the petitioners here, have signed such an acknowledgement.

According to respondent, a contrary reading would give absurd results, as a borrower could rescind by notice to the lender, who would have to cancel the mortgage within 20 days even though the lender does not agree that the borrower has a right to rescind. Sending such a letter costs little or nothing to the borrower, particularly if the loan is already in default and foreclosure, and the sender is not subject to the sanctions available for groundless lawsuits or defenses. Borrowers could send spurious rescission notices within three years, keeping open the possibility of bringing suit thereafter and forcing lenders to bring "avoidable and unnecessary" declaratory judgment actions to establish the enforceability of their loans.

The unlimited duration of the rescission right, as TILA was initially drafted, created just such a cloud on the "titles and enforceability of loans," as a result of which the three-year time limit in section 1635(f) was added. Respondent asserts that it is a statute of repose that operates as an absolute bar because the right of rescission is terminated, leaving no cause of action on which to file a suit. Petitioner argues that this section merely requires that the borrower send a notice of intent to rescind within the three-year period, and that no cause of action exists unless and until a lender rejects a borrower's notice of rescission. It is that rejection which gives rise to the basis for the suit, petitioners conclude, and thus triggers the running of any statute of limitations.

SIGNIFICANCE

The majority of residential mortgage loans are sold in secondary markets and the outcome of this case could affect the marketability of mortgages, with ramifications for mortgage availability and cost. The securitization industry argues that if a mortgage can be automatically voided by the borrower's notice of intent to rescind, risks increase and interest rates will follow. Similarly, a ruling that the three-year statute of repose is not an absolute bar and that a notice of intent to rescind provided within that period will keep the cause of action alive would affect values both by clouding the lender's rights and by increasing overall litigation costs. It should be noted, however, that while the parties have tended to merge the arguments, there is no inherent reason why the Court could not split them, holding that the notice of intent to rescind does not cause an automatic rescission where the lender contests it, and that section 1365(f) does not preclude a subsequent suit provided the notice is sent within the three-year window.

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PREVIEW of United States Supreme Court Cases, pages 66–69.

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In Support of Respondent Countrywide Home Loans

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The Quotable Court

In October, the Court heard a number of interesting cases. Below we highlight some of the more engaging exchanges between the justices and the advocates during *Integrity Staffing Solutions v. Busk* (Docket No. 13-433). That case raised the question of whether time spent in security screenings is compensable under the Fair Labor Standards Act, as amended by the Portal-to-Portal Act.

Paul Clement (on behalf of the petitioners): And I think two points to make here. One is, you know, I think the knife sharpening in *King Packing,* for example, really is indispensable. You can't run a butchering operation without sharp knives. I think you can perfectly well run a warehouse facility without egress security. So I think these are different.

Justice Elena Kagan: Actually, Amazon, I don't think you can. I mean, what makes it Amazon? It's a system of inventory control that betters everybody else in the business. And what's really important to Amazon is that it knows where every toothbrush in the warehouse is. And that's just as integral to what Amazon does and to what it requires its employees to do as, for example, the—I'm going back to my hypos—but the person who closes out the cash register, the person who closes out the bank teller operation, is that this is sort of a necessary part of what the folks who do all the stocking and the unshelving and shelving do at Amazon.

Mr. Clement: Well, I guess I would beg to differ, Justice Kagan. I think, certainly, everything in the Amazon facility is barcoded and the like, and everybody knows where everything is, but there's always the possibility that somebody [did] not barcode an incoming item at all and put it in their pocket. Now, if they're doing that, they're not discharging their principal activities, and if they're detected on the way out, I mean, that might help keep the next person on mission, but that doesn't make it integral and indispensable to discharging the primary job duty.

Justice Antonin Scalia: I suppose that it is also necessary to Amazon's business that it know how many hours each of its workers has worked, so it knows how much to pay them and doesn't pay them more, right? And—and yet, there's no doubt whatever, is there, that punching in and punching out is not preliminary and postliminary, right?

Mr. Clement: I hope there's no doubt about that, Justice Scalia. And I do think that the exit security screenings are just the modern analogue of that. Not only do they both come at the employer's insistence and for the employer's benefit, but they also have this process of verifying that the employers are essentially behaving in an honest way.

* * * *

Mark Thierman (on behalf of the respondents): But there are employers who say—they're OCD, they want everyone there till 8 o'clock, even if you have nothing to do. I'm paying you to stay till 8 o'clock, you stay till 8 o'clock. There's nothing that is coming out of that, but yet you are told to stay, so you stay. And there's no function to it. I mean, the employers do things like that or they do it for reasons that we don't know or we won't understand and we don't care because that's our system. They are allowed to run their business that way. And a corollary of that is that they tell people what to do. . . .Whatever it is, if the employer tells to you do it and it's not within these carveouts, it is compensable. And the drug testing is another example. The drug testing is compensable. Why? Because your freedom—you're giving up your time. Your freedom isn't—and you're doing it because the employer told you to do it.

Justice Antonin Scalia: Suppose the employer has enough stations that it just takes a minute to go through. Would you still be making the argument that that's compensable?

Mr. Thierman: If the—if the employees go through in a minute, it's de minimis. And that's the safety valve or the escape valve. First, we decide if it's work; second, we decide if it's within the postliminary and preliminary carveout; and third, we decide if it's de minimis.

Justice Scalia: Gotcha. Okay. Five minutes?

Mr. Thierman: The Ninth Circuit uses a ten-minute rule. It varies. I mean, if it's constantly done every day for ten minutes exactly, it gets close. But three minutes, it's trivial. ■