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## Just When You Thought it was Safe to go in the Water: Recent Court Decisions Regarding Yield Spread Premiums Class Certification

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# FEATURE ARTICLES

## Just When You Thought it was Safe to go in the Water: Recent Court Decisions Regarding Yield Spread Premiums Class Certification

by Robert M. Jaworski, Esq.

After the Eleventh Circuit's clarification of its earlier decision in *Culpepper v. Inland Mortgage*<sup>1</sup> and the decision in *Taylor v. Flagstar Bank, FSB*,<sup>2</sup> the controversy over payment of yield spread premiums might have been thought to have finally ended. Unfortunately, the U.S. District Court for the District of New Hampshire recently handed down a decision that may provide class actions with more ammunition to continue to pursue these cases.<sup>3</sup> This article will discuss yield spread premiums, recent court decision concerning this issue and how such decisions have left an air of uncertainty as to how the courts and even Congress will address the issue in the future.

### Yield Spread Premiums

Yield spread premiums, ("YSPs") are compensations received by a mortgage broker from a mortgage lender for originating a loan at an interest rate ("point") above the

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benchmark rate, i.e. the rate at which the lender would otherwise agree to make the loan. Over the past year and a half, consumers have bombarded courts around the country with class action suits alleging that YSPs violate the United States Real Estate Settlement Procedures Act, ("RESPA").<sup>4</sup> Under RESPA, it is illegal for a mortgage broker to accept a fee merely for referring business to a mortgage lender when the transaction involves a federally regulated mortgage loan.<sup>5</sup>

RESPA, however, excludes from this prohibition any payment of compensation for goods or facilities actually furnished or work actually performed.<sup>6</sup> The common question in yield spread premium cases is often whether a fee given by a mortgage broker to a mortgage lender is in fact compensation for goods or facilities furnished or work performed. From the industry perspective, YSPs represent part of the broker's compensation for the services he or she provides to the customer. Lenders argue that yield spread premiums operate merely as a pricing mechanism to enable consumers who cannot, or do not wish to, pay their broker's fee "up front" (at the closing) to finance the cost of the broker's services over the life of the loan through a slightly higher interest rate. The plaintiffs allege that YSPs are illegal referral fees in violation of Section 8 of RESPA.

The primary battleground on which this recent waive of YSP class action cases has been fought is on the issue of class certification. Under Federal Rule of Civil Procedure 23(a), to have a class

certified, plaintiffs must show that (1) the class is so numerous that joining all members is not practical, (2) there are questions of law or fact common to all members of the class, (3) the claims of the class representatives are typical of the claims or defenses of the other members of the class, and (4) the class representatives will fairly and adequately protect the interest of the other class members.<sup>7</sup> More than one hundred and fifty class action complaints have been filed over the last several years by persons challenging the legality of yield spread premiums. To date only two cases have reached a determination on the merits, both in favor of the lender.<sup>8</sup>

### **Georgia Court Denies Motion to Consolidate Claims**

In July 1998, the U.S. District Court for the Northern District of Georgia denied plaintiffs' motion to consolidate nineteen separate YSP cases for purposes of discovery and trial in *Jackson v. Ford Consumer Finance Company, Inc.*<sup>9</sup> In that case, separate lawsuits were brought against various lenders alleging that the lenders made payments to mortgage loan brokers in violation of RESPA. Consolidation motions are essentially an appeal to the court's discretion. The court must determine whether the risk of prejudice and potential confusion posed by juggling multiple cases that are similar yet not identical outweighs the risk of separate courts hearing the cases and reaching inconsistent decisions of law or fact. The court

must also weigh the burden placed on the parties involved, the availability of resources and witnesses, the time needed to try the cases, and the expenses involved litigating separate cases. Federal Rule of Civil Procedure 42(b) states, "consolidation of lawsuits may be granted when all of the cases involved have common questions of law and fact and where the court believes that consolidation will help to expedite the trial and eliminate unnecessary repetition and confusion."<sup>10</sup>

In rejecting the motion, the court applied the Eleventh Circuit's standard in *Culpepper v. Inland Mortgage*.<sup>11</sup> The court observed that liability for the loan transactions at issue was dependent on the facts of the individual transactions.<sup>12</sup> The court also indicated that the plaintiffs failed to show that the transactions at issue or the lenders' practices were so similar that economics could be achieved through consolidation.<sup>13</sup> The court reasoned that confusion and duplication of effort would result from the participation of eighteen different lenders in discovery and pretrial matters regarding transactions in which only one or two of the lenders might have had any involvement.<sup>14</sup> To avoid confusion, the court denied the motion to consolidate and each individual YSP case was returned to its original court.

### **Denial of class Certification in Two Circuits**

In *Chandler and Wayne v. Washtenaw Mortgage Company*, the court, who had

earlier issued the *Taylor* decision, rejected the plaintiffs' motion to consolidate for the same reasons expressed in *Taylor*.<sup>15</sup> Quoting from *Taylor*, the court observed that, "[t]he mere fact that the borrower paid some compensation [to the broker in table-funded transaction] does not automatically mean that the YSP in not compensation" properly paid for the broker's services.<sup>16</sup> In the court's view, a lender may always defend itself, in some or all of the challenged transactions, on the basis that the YSPs "are additional payments for the services rendered for which the borrower also paid a brokerage fee."<sup>17</sup> The court refused to accept, as the plaintiffs urged, that the compensation paid by the borrower directly to the broker was intended as full compensation for the broker's services.<sup>18</sup> Significantly, the court explained that although defendants submitted an affidavit by the mortgage broker stating that it would have charged the borrower more for its services if it would not have received the YSP from the lender, such a showing was not necessary to defeat class certification; thus, denial of class certification could rest merely on the "possibility that a yield spread premium may have been intended as additional compensation."<sup>19</sup>

Similarly, in August 1998, the U.S. District Court in Minnesota rejected a class certification motion in another YSP case, *Schmitz v. Aegis Mortgage Corporation*.<sup>20</sup> In doing so, the court illustrated the importance of the Eleventh Circuit's decision on a

rehearing in *Culpepper*, noting that:

[a]lthough the *Culpepper v. Inland Mortgage* decision may lend support for the merits of plaintiff's claim, the posture of the *Culpepper v. Inland Mortgage* case involved the grant and subsequent reversal of summary judgment. The Eleventh Circuit clarified that, on remand, the defendant would be permitted to introduce evidence of services provided by the mortgage broker to the mortgage lender.... In addition, the *Culpepper v. Inland Mortgage* decision did not address class certification.<sup>21</sup>

The court then ruled that the plaintiff failed to satisfy the predominance requirement of Federal Court Rule 23(b)(3) (that common questions of law or fact predominate over any questions involving only individual members).<sup>22</sup> The court further agreed with the court's analysis in *Taylor v. Flagstar* that the trier of fact will be called upon to determine whether the yield spread premium was intended to be additional payment for the broker's services to the lender and borrower and then, if so, whether there is any excess payment over the reasonable...market value of the services provided.<sup>23</sup>

### **A New Hampshire District Court Goes Its Own Way**

In August 1998, the U.S. District Court in New Hampshire decided

*Mulligan v. Choice Mortgage Corp., USA*.<sup>24</sup> In *Mulligan*, the plaintiffs decided to refinance their homes in 1996 and signed an agreement with Choice Mortgage to assist them in finding a suitable lender.<sup>25</sup> The agreement provided that Choice would provide the plaintiffs with the best possible loan program for their needs.<sup>26</sup> In return for this service, the plaintiff agreed to pay Choice Mortgage a 3% brokerage fee and reimbursement of administrative expenses.<sup>27</sup> Choice Mortgage was able to find a loan for the named plaintiff in the amount of \$124,000 from a mortgage lender.<sup>28</sup> As a result, at their refinancing closing, the named plaintiff paid Choice Mortgage \$3,720 as a brokerage fee and more than \$800 to cover administrative expenses.<sup>29</sup>

The plaintiffs alleged that, at the closing, Choice Mortgage also received a payment of \$3,720 from the approving lender as a referral fee for securing from the plaintiffs an agreement to enter into a mortgage loan at an interest rate higher than that at which the lender would otherwise have agreed to make the loan.<sup>30</sup> This fee, the plaintiffs alleged, was in violation of RESPA.<sup>31</sup> In addition, the plaintiff alleged that their claims were part of a pattern of misconduct whereby Choice Mortgage similarly took advantage of other individuals in different loan applications.<sup>32</sup>

The plaintiffs brought a class action complaint against Choice Mortgage alleging violations of RESPA, the Racketeering Influence and Corrupt Organizations Act, ("RICO"), and the

New Hampshire Consumer Protection Act.<sup>33</sup> In addition, the plaintiff alleged that Choice Mortgage breached the fiduciary duty it owed to class members based on the contracts it held with them, and committed common law fraud.<sup>34</sup> As a result, the plaintiffs moved to certify a class of one hundred-thirteen individuals who entered into mortgage transactions where Choice Mortgage acted as the mortgage broker and received payments from the borrower and the lender.<sup>35</sup>

Taking its cue from the unbroken line of YSP cases in which class certification has been denied, Choice argued that if class certification were granted individual issues would predominate over any common questions.<sup>36</sup> In addition, the trier of fact would be unable to determine whether any of the YSP payments made to Choice constituted payment "for goods or facilities furnished or for services actually performed" without first undertaking a case-by-case analysis as to whether the payment bore a "reasonable relationship" to the market value of any services Choice provided to the lender or the borrower.<sup>37</sup>

The court, however, took a different view. The court appeared to accept plaintiffs' bold assertions that (1) because plaintiffs' paid Choice a brokerage fee for its services, the lender's payment to Choice could not have constituted compensation for services to the borrower, and (2) because the amount of the payment varied exclusively according to the

difference between the lenders' "par" rate and the rate at which the loan closed, the lender's payment to Choice could not have been compensation for services performed for the lender.<sup>38</sup>

A key factor in court's decision was that Choice Mortgage apparently "failed to offer any evidence or arguments to counter these assertions."<sup>39</sup> However, the court in *Chandler v. Washtenaw Mortgage Co.* stated that such an offer is not necessary to defeat class certification.<sup>40</sup> Additionally, it is enough that it is possible for the yield spread premium to have been intended as additional payment for the broker's services to the lender and borrower; such a possibility renders it likely that a determination of RESPA liability would require a fact-intensive inquiry into each and every loan transaction.<sup>41</sup>

Furthermore, the decision in *Mulligan* acknowledged that YSP's are not per se illegal, yet "it does not necessarily follow that a RESPA claim can never be suitable for certification as a class action."<sup>42</sup> Moreover, in this case, "the evidence demonstrates that plaintiffs' RESPA claims will succeed or fail predominantly because of issues common to the class as a whole."<sup>43</sup> However, only if there is no possibility that the YSP payment in connection with any loan could have represented additional compensation for services provided by the broker to the borrower or the lender. If that possibility exists, then a case-by-case factual analysis would seem to be necessary to ferret out each transaction in which such possibility exists and then to determine

what services the broker provided and whether the total compensation received by the broker from the lender and the borrower was reasonable.

Several facts may help to explain the result in *Mulligan*. First, Choice Mortgage's brokerage agreement with its customers specified that Choice Mortgage would "endeavor to provide [the borrowers] the best possible loan for [their] specific needs."<sup>44</sup> While this should not have been a dispositive factor (since it is entirely possible that Choice Mortgage could show that the loan a particular borrower received was the best possible loan for his or her situation), it certainly seems to have cast Choice Mortgage, perhaps undeservedly, in a somewhat harsh light. As stated by the court, "[i]t seems highly unlikely that any member of the putative class had a 'specific need' to borrow money at an interest rate higher than that at which the lender was otherwise willing to charge."<sup>45</sup> However, the fact is that it may well have been better for the borrower to pay the higher rate if that meant that they would not have to pay more up front to the broker.

Second, the case is a relatively small one, with only 113 class members, involving 72 loan transactions, geographically concentrated in just two states, New Hampshire and Massachusetts, and brokered by only one mortgage broker.<sup>46</sup> In light of these numbers, the court may well have considered the possibility that the case was manageable even if the court ends up having to examine the facts of some or all of the individual transactions. In

this regard, the court may not have fully appreciated the extent to which individual loan transactions may vary in terms of borrower characteristics, lender requirements, loan program parameters and qualifications, and the work involved in putting together a loan package that will be accepted by the lender.

Third, it appears that Choice did not assert that if it had not received a yield spread premium, it would have charged the borrower more. Although as indicated earlier, the Taylor court found dispositive the mere *possibility* that a YSP was intended as additional compensation to the broker for its services to the borrower, the fact that such an assertion was made in that case probably helped to crystallize the lender's argument and give it substance. The decision in *Mulligan* does not even admit of this possibility.

Finally, there is the fact that no lender was sued in *Mulligan*, only the broker, Choice Mortgage. We can only speculate whether that fact alone would be sufficient to distinguish *Mulligan* from future YSP class certification decisions in cases in which lenders are also involved as defendants. However, it seems beyond dispute that the introduction of a lender, or multiple lenders, into a YSP class action case would certainly complicate matters. For example, it might require that the court examine not only the broker's contract and conduct, but also any and all relevant provisions in the correspondent loan agreements between the broker and the lender(s), the content and timing of

disclosures provided by the lender(s), the lender(s)' pricing policies, etc. These complications, had they been present in *Mulligan*, may well have tipped the scales in favor of denying class certification.

### Conclusion

The significance of the *Mulligan* decision is still in question. Lenders obviously hope that *Mulligan* will prove to be an aberration — a dark blip on an otherwise bright radar screen. The next couple YSP decisions should provide a good indication whether this hope will become a reality.

In addition, *Mulligan* may also renew Congressional interest in enacting the YSP class action moratorium bills that are currently pending in both the House and Senate. In April 1997, Representative Robert Ehrlich of Maryland introduced HR 1283, the Real Estate Settlement Procedures Class Action Relief Act of 1997, ("Moratorium Bill"). The bill was drafted as a result of the growing number of YSP class action lawsuits. By December 1997, the bill has the support of ninety-two other sponsors. If enacted, the Moratorium Bill would put an end to any pending yield spread premium class actions. Representative Ehrlich, who introduced HR 1283 in the House, is already on record as saying that, in light of the outcome of *Mulligan v. Choice Mortgage*, his legislation is needed more urgently than ever. In any event, it is possible that the coming months will constitute a defining moment in the evolution of the yield spread premium debate.

### ENDNOTES

- <sup>1</sup> 132 F.3d 692 (11th Cir. 1998), request for reh'g en banc denied, 144 F.3d 717 (11th Cir. 1998).
- <sup>2</sup> 181 F.R.D. 509 (M.D.Ala. 1998).
- <sup>3</sup> See *Mulligan v. Choice Mortgage Corp.*, 1998 WL 544431 (D.N.H. 1998).
- <sup>4</sup> See 12 U.S.C. § 2601. (1996).
- <sup>5</sup> See *id.* at 2607(a).
- <sup>6</sup> See *id.*
- <sup>7</sup> See Fed. R. Civ. Pro. 23(a).
- <sup>8</sup> See *Barbosa v. Target Mortgage Corp.*, 968 F. Supp. 1548 (S.D. Fla. 1997)(explaining motion for partial summary judgment), *C.H. Dubose v. First Security Savings Bank*, 974 F. Supp. 1426 (M.D.Ala.1997)(returning jury verdict in favor of the lender).
- <sup>9</sup> 181 F.R.D. 537 (N.D. Ga. 1998).
- <sup>10</sup> Fed. R. Civ. Pro. 42(b).
- <sup>11</sup> See *Culpepper*, 132 F.3d at 695.
- <sup>12</sup> See *Jackson*, 181 F.R.D. at 540.
- <sup>13</sup> See *id.*
- <sup>14</sup> See *id.*
- <sup>15</sup> (M.D. Ala. 1998).
- <sup>16</sup> *Id.*
- <sup>17</sup> *Id.*
- <sup>18</sup> See *id.* (emphasis added).
- <sup>19</sup> *Id.*
- <sup>20</sup> Civ. No. 97-2142, slip op. (D. Minn. 1998).

21 *Id.* at 14. 43 *Id.*  
22 *See id.* at 15. 44 *Id.* at 6.  
23 *Id.* 45 *Id.*  
24 1998 WL 544431 (D. N.H. 1998). 46 *See id.* at 5.  
25 *See id.* at 1.  
26 *See id.*  
27 *See id.*  
28 *See id.*  
29 *See id.*  
30 *See id.*  
31 *See id.*  
32 *See id.*  
33 *See id.*  
34 *See id.*  
35 *See id.*  
36 *See id.* at 5.  
37 *Id.*  
38 *See id.* at 6.  
39 *Id.*  
40 *See Chandler*, (M.D. Ala. 1998).  
41 *See id.*  
42 *Mulligan*, 1998 WL 544435.

