

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MARYLAND

GABRIEL NKENGFACK, et al., *

Plaintiffs, *

Civil No. RDB 08-2746

v. *

HOMEcomings FINANCIAL, LLC *

Defendant. *

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* * * * *

MEMORANDUM OPINION

Plaintiff Gabriel Nkengfack (“Plaintiff” or “Nkengfack”), individually, and on behalf of others similarly situated, has brought this putative class action suit against the mortgage company, Homecomings Financial, LLC (“Homecomings”) asserting claims for violations of the Truth in Lending Act (“TILA”), 15 U.S.C. § 1601, *et seq.*, the Maryland Consumer Protection Act (“MCPA”), Md. Com. Law Code Ann. § 13-101, *et seq.*, and Maryland common law. Plaintiff alleges that when he entered into an “Adjustable Rate Note Payment Option” loan agreement with Homecomings, he was provided with certain mortgage loan documents that failed to comply with federal and state disclosure laws. On December 12, 2008, Homecomings filed the instant Motion to Dismiss Complaint (Paper No. 17). The issues have been fully briefed and a hearing was held on April 22, 2009. For the reasons stated below, Defendant’s motion is GRANTED.

BACKGROUND

In ruling on a motion to dismiss, “[t]he factual allegations in the Plaintiff[s]’ complaint must be accepted as true and those facts must be construed in the light most favorable to the plaintiff[s].” *Edwards v. City of Goldsboro*, 178 F.3d 231, 244 (4th Cir. 1999).

On or about October 11, 2006, Plaintiff entered into an “Adjustable Rate Note Payment Option” (“ARM Note”) with Homecomings in order to refinance his existing home loan that was secured by his primary residence in Gwynn Oak, Maryland. (Compl. ¶ 7.) Homecomings, a Delaware company with its principal place of business in Minnesota, is engaged in the business of promoting, marketing, and selling the adjustable rate payment option loans, or “Option ARM” loans, that are the subject of Plaintiff’s suit. (*Id.* ¶ 8.)

In his Complaint, Plaintiff states that “[a]n Option ARM mortgage is a mortgage that gives the borrower multiple monthly payment options. When the borrower receives his or her monthly statement, it provides options to pay a minimum payment amount, an interest only payment, a payment based on a 30-year amortization, or a payment based on a 15-year amortization.” (*Id.* ¶ 15.) Plaintiff adds that

Up to 80 percent of all Option ARM borrowers make only the minimum payment each month, often because they are not properly informed about the terms of the loan. The minimum payment does not pay down any of the principal balance of the loan and only pays a portion of the interest that accrues on a monthly basis. The unpaid interest is then added to the balance of the mortgage, a process called “negative amortization.”¹ Once the balance reaches a set amount, in this case 115 percent of the original loan principal, the loan is automatically recast as a fully amortizing loan with a resulting monthly payment far higher than the payment the borrower had been previously making.

¹ In *Plascencia v. Lending 1st Mortgage*, No. 07-4485, 2008 U.S. Dist. LEXIS 91154, at *5 (N.D. Cal. Apr. 28, 2008), the court further explained negative amortization:

Because Plaintiffs’ initial minimum monthly payment was based on a [low “teaser rate”] and did not go up along with the almost immediate increase in their interest rate, their mortgage began accruing more interest each month than the entire amount of their payment. The interest that was left unpaid at the end of each month was added to the outstanding principal and began accumulating interest itself. As a result, Plaintiffs’ principal has grown even while they have made the minimum payment each month. This process is known as negative amortization.

(*Id.* ¶ 19.)

At the closing of the transaction, Plaintiff received, in addition to the ARM Note, a Truth in Lending Disclosure Statement (“TILDS”), and an Adjustable Rate Mortgage Loan Program Disclosure (“Program Disclosure”). (Compl. ¶ 7.) The TILDS and the Program Disclosure are documents mandated by the Truth in Lending Act (“TILA”) that provide certain information regarding the loan in a form required by law.

Plaintiff claims that the loan documents issued by Homecomings violate TILA because they fail to clearly and conspicuously disclose to borrowers material facts relating to the “Option ARM” loans. More specifically, Plaintiff alleges that Homecomings violated TILA by failing to clearly disclose: (1) negative amortization (Compl. ¶¶ 57-67); (2) the legal obligation of the parties (*Id.* ¶¶ 71-78); (3) the interest rate upon which the payment schedule was based (*Id.* ¶¶ 68-70) and the fact that the payment schedules in the TILDS are not based on the actual interest rate (*Id.* ¶¶ 49-56); and (4) the effect of the payment cap on the true cost of the loan (*Id.* ¶¶ 79-82). In addition, Plaintiff alleges that Homecoming’s deceptive practices support his claims in Count Two under the Maryland Consumer Protection Act (“MCPA”) and in Count Three under state law breach of contract.

On December 12, 2008, Homecomings moved to dismiss the Complaint under Fed. R. Civ. P. 12(b)(6). Defendant argues that a straightforward application of TILA to Plaintiff’s loan documents reveals that no violation has been alleged. It adds that even if a TILA violation is found to be properly alleged, Count One must be dismissed because the two forms of relief provided for by TILA—rescission and damages—are unavailable in this case since Homecomings has already agreed to rescind Plaintiff’s loan and its claim for damages is barred by the one-year statute of limitations. Finally, Homecomings adds that the state law claims

asserted in Counts Two and Three are derivative of the failed TILA claim in Count One and therefore must be dismissed as well.

ANALYSIS

I. Alleged Truth in Lending Act (“TILA”) Violations (Count I)

A. Plaintiff Has Properly Alleged a TILA Violation

Upon reviewing the various allegations in the Complaint relating to Count One, this Court finds that at a minimum, Plaintiff has properly alleged that Homecomings failed to clearly disclose the risk of negative amortization in violation of the Truth in Lending Act. (Compl. ¶¶ 57-67.)

This Act is a consumer protection statute enacted by Congress “to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices.” 15 U.S.C. § 1601(a). Pursuant to its congressionally-delegated authority, the Federal Reserve Board implemented TILA through its issuance of Regulation Z, *see* Regulation Z, 12 C.F.R. § 226, *et seq.*, and its interpretations and Official Staff Commentary. *See* 12 C.F.R. § 226, *et seq.* Under Regulation Z, lenders are required to make certain preliminary disclosures when they issue loans with a variable rate feature. 12 C.F.R. § 226.19. Such disclosures must be “clear and conspicuous” and be “presented in a way that does not obscure the relationship of the terms to each other.” 12 C.F.R. § 226.17(a)(1). Finally, courts have noted that TILA is a remedial statute that is liberally construed in the favor of consumers, *see Begala v. PNC Bank, Ohio, N.A.*, 163 F.3d 948, 950 (6th Cir. 1998), and that “a misleading disclosure is as much a violation of TILA as a failure to

disclose at all.’” *Barnes v. Fleet Nat. Bank, N.A.*, 370 F.3d 164, 174 (1st Cir. 2004) (quoting *Smith v. Chapman*, 614 F.2d 968, 977 (5th Cir. 1980)).

Homecomings failed to expressly state in the TILDS or in the ARM Note that negative amortization was certain to occur if Plaintiff followed the payment schedule provided. No such statement was given despite the fact that the minimum monthly payment for the first five years of the loan was insufficient to cover the interest due on the loans and was guaranteed to result in negative amortization of 115% of the original loan amount. Instead, in several places in the loan documents, Homecomings merely noted that negative amortization was a possibility. For instance, the Program Disclosure states that “if you pay only the minimum monthly payment, your loan *may* have negative amortization” (emphasis added), despite the fact that Homecomings knew that the minimum monthly payment would result in the loan principal increasing through negative amortization until the loan was “recast” approximately five years after the closing. The Program Disclosure also provides that “if you pay only the minimum monthly payment, the amount *may not* be sufficient to cover the interest due on your loan” (emphasis added), while Homecomings knew that the minimum monthly payment would be insufficient to cover the interest due on the loans during the first five years of repayment.

Several district courts have allowed nearly identical claims to survive on the basis that TILA mandates the disclosure of the certainty of negative amortization. *See, e.g., Mincey v. World Savings Bank, FSB*, No. 07-3762, 2008 U.S. Dist. LEXIS 73898, at *72-73 (D.S.C. Aug. 15, 2008) (granting partial judgment on the pleadings in favor of plaintiff borrowers upon finding that the defendant lender had violated TILA “by disclosing negative amortization was a possibility when in fact it was a certainty.”); *Plascencia v. Lending 1st Mortgage*, No. 07-4485, 2008 U.S. Dist. LEXIS 91154, at *18-19 (N.D. Cal. Apr. 28, 2008) (finding that “the Note’s

reference to negative amortization as a hypothetical event does not clearly and conspicuously disclose . . . ‘that negative amortization *will* occur and the principal loan balance *will* increase.’” (emphasis in original; quoting 12 C.F.R. Pt. 226)); *Pham v. T.J. Fins., Inc.*, No. 08-275, 2008 U.S. Dist. LEXIS 72150, at *6 (C.D. Cal. Aug. 11, 2008) (same); *Ralston v. Mortgage Investors Group, Inc.*, No. 08-536, 2009 U.S. Dist. LEXIS 24288, at *17 (N.D. Cal. Mar. 16, 2009) (same); *Mandrigues v. World Sav., Inc.*, No. 07-4497, 2008 U.S. Dist. LEXIS 103011, at *8-9 (N.D. Cal. 2008) (same). Because the facts alleged in Plaintiff’s Complaint regarding negative amortization are remarkably similar to the facts presented in the cases listed above, this Court finds that Nkengfack has cited a substantive violation of TILA in Count One.

B. The TILA Remedies Sought by Plaintiff are Unavailable

Although a substantive violation of TILA has been referenced in Count One of the Complaint, this claim must nevertheless be dismissed because neither rescission nor damages is at issue in this case. The Defendant agreed to rescind the loan, but the Plaintiff failed to take the appropriate steps to complete the rescission process and failed to timely file this lawsuit.

i) Rescission

TILA provides that after a borrower gives notice of his intent to exercise his rights to rescind, a creditor has twenty days to initiate the process of rescission. 15 U.S.C. §§ 1635(a) & (b). TILA rescission is designed to be a private remedy that is performed without judicial intervention. *See Andrews v. Chevy Chase Bank*, 545 F.3d 570, 573-74 (7th Cir. 2008) (“TILA rescission is . . . considered a purely personal remedy It is intended to operate privately, at least initially, with the creditor and debtor working out the logistics of a given rescission.”) (citations and quotations omitted). A borrower is only permitted to bring a cause of action for rescission in the event that a creditor fails to appropriately respond to a valid notice of rescission.

See Jefferson v. Security Pacific Fin'l Serv., Inc., 161 F.R.D. 63, 69 (N.D. Ill. 1995) (“TILA gives the creditor twenty (20) days to act on a rescission claim before the matter can be brought before a court.” (citing *James v. Home Constr. Co.*, 621 F.2d 727, 731 (5th Cir. 1980))).

Plaintiff provided adequate notice of his intention to rescind by filing his Complaint seeking rescission as a remedy. *See Jones v. Saxon Mortgage, Inc.*, 537 F.3d 320, 327 (4th Cir. 1998) (“the filing of a lawsuit can be sufficient written notice of rescission under TILA so long as the complaint seeks rescission”). Homecomings timely agreed, within twenty days of service of the Complaint, to rescind the loan transaction. In order to complete the rescission process, Plaintiff was thereupon required to tender the loan proceeds in order to “unwind[] the transaction in its entirety” *Andrews*, 545 F.3d at 573 (quotations omitted); *see* 15 U.S.C. § 1635(b) (requiring borrower to tender the reasonable value of the property, less interest and other charges, in order to consummate the rescission process).

Because Plaintiff has withheld payment of the loan proceeds to Homecomings, he has failed to perform the steps necessary to complete the rescission process. Therefore, Plaintiff is not authorized under TILA to seek a judicial order of rescission. *See Personius v. HomeAmerican Credit, Inc.*, 234 F. Supp. 2d 817, 819 (N.D. Ill. 2002) (dismissing plaintiff’s rescission claim because the creditor’s “offer to rescind the loans rendered plaintiffs’ claims for rescission moot The relief that plaintiffs sought and was available to them was fulfilled by [Defendant]’s agreement to rescind the loans”).

Finally, this Court rejects Plaintiff’s claim that he can assert a rescission claim on behalf of members of the putative class, as courts have repeatedly held that claims for rescission under TILA cannot be pursued on a class-wide basis. *See, e.g., Andrews*, 545 F.3d at 571; *McKenna v.*

First Horizon Home Loan Corp., 475 F.3d 418, 427 (1st Cir. 2007); *James v. Home Constr. Co. of Mobile, Inc.*, 621 F.2d 727, 728 (5th Cir. 1980).

ii) Damages

Claims for damages under TILA must be brought “within one year from the date of the occurrence of the violation.” 15 U.S.C. § 1640(e). In this case the statute of limitations began on October 11, 2006, the date the loan transaction closed. *See Mincey*, 2008 U.S. Dist. LEXIS 73898, at *60 (“[i]f the violation is one of disclosure in a closed-ended credit transaction, the date of the occurrence of the violation is no later than the date the plaintiff enters the loan agreement”). Plaintiff did not file his Complaint until October 20, 2008—more than two years after the alleged violation. Thus, Plaintiff’s claim for civil damages under TILA is time-barred.

Plaintiff argues that the Complaint asserts a damages claim on behalf of a national class that includes borrowers who obtained Option ARM loans from Homecomings within one year of the date the lawsuit was filed. As a result, Plaintiff contends that even through his claim for damages is time-barred, he should be afforded the opportunity to conduct discovery to identify class members whose loans closed within one year of the date that suit was filed.

However, this Court rejects the notion that Plaintiff’s TILA claim should be saved merely because he claims to bring his claims on behalf of a putative class. Nkengfack—the only named plaintiff who alleges a claim against Homecomings in this action—cannot be deemed a proper class representative under Fed. R. Civ. P. 23 since his TILA claim is time-barred. *See Weinberger v. Retail Credit Co.*, 498 F.2d 552, 556 (4th Cir. 1974) (holding that named plaintiff whose claim was time-barred could not represent class); *Courtney v. Smith*, 297 F.3d 455, 467 (6th Cir. 2002) (same); *see also Central Wesleyan College v. W.R. Grace & Co.*, 6 F.3d 177, 188 (4th Cir. 1993) (stating that it is “essential that named class representatives demonstrate standing

through a ‘requisite case or controversy between themselves personally and [defendants],’ not merely allege that ‘injury has been suffered by other, unidentified members of the class to which they belong and which they purport to represent.’” (quoting *Blum v. Yaretsky*, 457 U.S. 991, 1001 n.13 (1982)); *Dash v. FirstPlus Home Loan Owner Trust 1996-2*, 248 F. Supp. 2d 489, 503 (M.D.N.C. 2003) (“[p]laintiffs’ characterization of their suit as a putative class action in no way cures [the standing] defect Otherwise, any plaintiff could sue a defendant against whom the plaintiff has no claim in a putative class action, on the theory that some member of the hypothetical class, if a class were certified, might have a claim”).

Finally, at the hearing on April 22, 2009, counsel for the Plaintiff stated that he had recently received notice about a nationwide class-action TILA lawsuit that had been filed in the United States District Court for the Central District of California. *See Carroll v. Homecomings Financial, LLC*, No. 2:07-cv-03775-AHS (C.D. Cal.). Plaintiff was granted the opportunity to investigate this lawsuit and to file supplemental briefing on the issue of whether the *Carroll* class action served to toll the running of the statute of limitations in the instant action under the doctrine set forth in *American Pipe & Construction Co. v. Utah*, 414 U.S. 538 (1974) and *Crown, Cork & Seal Co. v. Parker*, 462 U.S. 345 (1983).² In his Supplemental Memorandum Addressing TILA Statute of Limitations (Paper No. 30), Plaintiff noted that the Second Amended Complaint in the *Carroll* case, which asserted for the first time a claim on behalf of a national class, was filed on January 28, 2008. Because this nation-wide claim was filed more than a year after the October 11, 2006 date when Nkengfack’s loan closed, Plaintiff conceded that *American Pipe* tolling did not apply to his TILA claim for damages.

² In *American Pipe*, the United States Supreme Court held that the statute of limitations is suspended for the benefit of absent class members who seek to intervene in the class action litigation. 414 U.S. at 557-58. In *Crown, Cork & Seal*, the Court ruled that the statute of limitations is also tolled for absent class members who chose to assert their own independent lawsuits rather than intervene in the putative class action. 462 U.S. 353-54.

II. State Law Claims (Counts II and III)

In addition to his TILA claim, Plaintiff has asserted claims under the Maryland Consumer Protection Act (Count II) and the Maryland common law for breach of contract and the implied covenant of good faith and fair dealing (Count III).

In his Complaint, Plaintiff relied upon 28 U.S.C. § 1331, the general federal question statute. Because Plaintiff's federal claim under TILA must be dismissed, this Court must therefore determine whether to retain supplemental jurisdiction over his pendent state law claims. *See* 28 U.S.C. § 1367(c)(3). In addressing this issue, the Supreme Court has advised that “a federal court should consider and weigh in each case, and at every stage of the litigation, the values of judicial economy, convenience, fairness, and comity in order to decide whether to exercise jurisdiction over . . . pendent state-law claims.” *Carnegie-Mellon Univ. v. Cohill*, 484 U.S. 343, 350 (1988) (citation omitted). The Court added that when “the balance of these factors indicates that a case properly belongs in state court, as when the federal-law claims have dropped out of the lawsuit in its early stages and only state-law claims remain, the federal court should decline the exercise of jurisdiction by dismissing the case without prejudice.” *Id.* (citation omitted).

In the present case, difficult issues remain concerning the viability of Plaintiff's state law claims—issues that were not adequately addressed by the parties in their briefs or at the hearing conducted on April 22, 2009. Such issues would be more appropriately resolved at a later date in the event the Plaintiff seeks to assert new claims in state court. For this reason, this Court declines to exercise supplemental jurisdiction over plaintiff's remaining state law claims, which are hereby dismissed without prejudice.

CONCLUSION

For the foregoing reasons, this Court GRANTS Defendant Homecomings Financial LLC's Motion to Dismiss Complaint (Paper No. 17). A separate Order follows.

Dated: June 15, 2009

/s/ _____
Richard D. Bennett
United States District Judge

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HOMECOMINGS FINANCIAL, LLC *

Defendant. *

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ORDER

For the reasons stated in the foregoing Memorandum Opinion, it is this 15th day of June, 2009, ORDERED that:

1. The Motion to Dismiss Complaint (Paper No. 17) filed by Defendant Homecomings Financial, LLC is GRANTED and Gabriel Nkengfack's claims are dismissed without prejudice;
2. Defendant Homecomings Financial, LLC's Second Request for Judicial Notice (Paper No. 25) and Corrected Motion for Leave to Submit Supplemental Authority Relevant to Defendant Homecomings Financial, LLC's Motion to Dismiss (Paper No. 28) are DENIED as moot;
3. The Clerk of the Court transmit copies of this Order and accompanying Memorandum Opinion to the parties and CLOSE this case.

/s/ _____
Richard D. Bennett
United States District Judge

