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Justices' Questioning In Jesinoski May Be Cause For Concern

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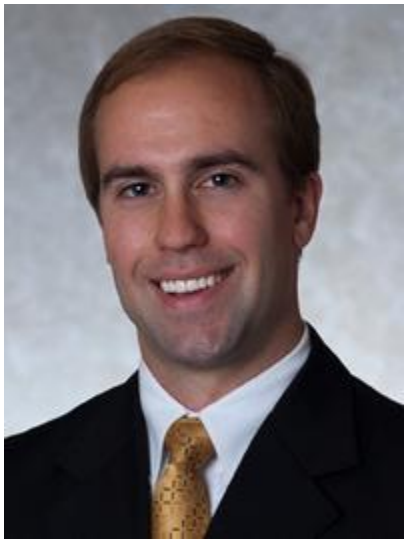

Sasha Leonhardt

Section 1635 of the Truth in Lending Act provides that a borrower may rescind certain mortgage loans within three days as a matter of right, and within three years if certain conditions are satisfied. The three-year extended rescission right applies only if a borrower does not receive certain material disclosures at loan closing.

But what if the creditor disagrees with the borrower regarding whether the borrower qualifies for the extended rescission period? For several years, the circuit courts have been split on whether in such cases a borrower who has provided notice of rescission within three years must also file a lawsuit within that three-year period, or whether such a borrower may file a lawsuit even after the three-year period lapses.

To date, four other circuits agree with the Eighth Circuit's position that rescission is only effective under TILA if the borrower files suit within three years of rescission. Three circuits, however, have held that a borrower need only provide notice to a creditor to rescind a loan transaction. On Nov. 4, 2014, the U.S. Supreme Court heard oral arguments in Jesinoski v. Countrywide to resolve this circuit split. In their questioning, the justices pressed counsel on whether the statutory text was clear and, if not, what steps a borrower must take to rescind.

In 2007, Larry and Cheryle Jesinoski refinanced their home mortgage loan. They claim that at the closing of the transaction, they did not receive two copies of the notice of right to rescind required by TILA. On the day before the three-year period ended, they sent written notice of their decision to rescind to their creditor. Later, after the three-year period expired, the Jesinoskis filed suit against their creditor demanding rescission. The district court dismissed, concluding that TILA required the Jesinoskis to file their lawsuit within the three-year period. The Eighth Circuit affirmed the district court decision, and the Jesinoskis appealed to the Supreme Court.

David Frederick, representing the Jesinoskis, proceeded through his argument with relatively light questioning from the court. Some of the justices, among them Justice Antonin Scalia, voiced their skepticism that a complete rescission really could be effected through a single, unopposed notice from a borrower, or that Congress would have permitted an entire loan transaction — in the Jesinoskis' case, a loan in excess of $600,000 — to become unsecured merely because the lender failed to provide the

borrower with two copies of the notice of right to rescind.

Frederick responded by repeatedly emphasizing a plain-text interpretation of the statutory language. When Justice Anthony Kennedy pressed the issue of rescission notices that — like the Jesinoskis' notice — were received only days before the three-year period ended, Frederick again turned to the statutory language, stating that Section 1635(b) provides a creditor with 20 days to research the borrowers' complaint and to respond if the creditor agrees that the borrower is entitled to rescind.

Counsel for the solicitor general's office, Elaine Goldenberg, also addressed the court briefly to articulate the views of both the U.S. Department of Justice and theConsumer Financial Protection Bureau, which participated in drafting the government's brief. Like Frederick, Goldberg met with little opposition from the bench.

Justice Samuel Alito pressed Goldenberg on how she would handle a potentially meritless rescission claim if she were the lender. Goldenberg replied that a creditor should resolve any issues with the borrower privately, and emphasized that the TILA rescission language "creates adversity" between the lender and the borrower and permits the lender to file suit to obtain a clear title.

Justice Kennedy continued to press the timing implications under TILA and asked Goldenberg whether TILA requires a lender to respond to a meritless rescission notice. Goldenberg took the position that a lender need not respond to a meritless rescission notice, and reiterated that if the creditor was concerned about the validity of its loan, the creditor could bring a declaratory judgment action.

Seth Waxman, counsel for Countrywide, argued that Section 1635(g) of TILA — which permits borrowers to sue creditors for violations under TILA generally — also governs the implementation of the rescission provision; thus, a borrower must file suit to rescind a loan within the three-year statutory period. Chief Justice John Roberts pushed Waxman, noting that it would be "very odd" to place so much weight on Section 1635(g) when Sections 1635(a) and (b) provided a road map to rescission.

Justice Elena Kagan echoed Chief Justice Roberts, stating that "this [Section 1635(g)] is not the way to write a dispute resolution section" and that the language in Section 1635(g) applied not to stand-alone rescission claims, but rather to instances in which a borrower brings a rescission claim along with other claims or in the context of another suit, such as a bankruptcy suit.

Justice Sonia Sotomayor further pressed Waxman on the statutory language, noting that his argument was based upon TILA's rescission provision being ambiguous. Justice Sotomayor noted that TILA generally was a very precise statute, including the rescission provision, and she saw no reason to read ambiguity into the otherwise clear statutory language.

The justices struggled with Waxman's argument that providing notice was only evidence of a borrower's "intention" to rescind, but was not actually effective to exercise the right to rescind. Waxman emphasized that "no court has held that notice is enough" to rescind; rather, Section 1635(b) outlines the necessary actions that the borrower and the lender must take to rescind the statue. Justice Kennedy disagreed, however, asking why timely notice would not be enough under the text of the statute. Waxman responded that the statute is not silent on what to do, and that Section 1635(g) provides borrowers a cause of action.

Justices Sotomayor and Kagan together pressed Waxman on the distinction that he drew between exercising a right to rescind (by filing notice) and actual rescission (which fully extinguishes the original

loan). Justice Sotomayor said that Section 1635(g) creates a borrower's right to sue, but not a requirement that a borrower file suit to rescind. Thus, she asked why specifically the borrower would have to file a suit.

Waxman responded that a rescission notice is an intention to unwind the transaction, but that filing suit is actually required to effect a rescission. Justice Sotomayor then asked if sending notice was exercising a right to rescind. Waxman said that it is only the borrower showing an intention to unwind, but that sending notice alone was not exercising the right to rescind.

Justice Scalia asked Waxman whether his case hinged upon the distinction between exercising the right to rescind and actual rescission, and Waxman agreed. Justice Kagan, looking to § 1635(f), pointed out that borrowers have three years to exercise the right of rescission and that Waxman had already conceded that to exercise the right of rescission is just to send notice. Waxman responded that, as a threshold issue, the borrower needs a live right of rescission to legitimately assert rescission. Justice Breyer then noted that court delays often make it impossible to resolve this threshold issue for months, if not years.

Justice Breyer was particularly forceful in challenging Waxman, noting that the statutory language appears straightforward because a borrower need only provide notice to rescind within the first three days. Quoting the statutory text to Waxman, Justice Breyer declared, "'Right to rescind ... by notifying the creditor.' Read the words." Waxman acknowledged the statutory text, but emphasized that it must be read in context and after three days, rescission depends upon whether the lender provided the notices required by TILA.

Finally, Justice Scalia raised the issue of whether the court should extend Chevron deference to the Federal Reserve Board's Regulation Z, which states that, "[i]f the required notice or material disclosures are not delivered, the right to rescind shall expire three years after consummation." Waxman responded that there was nothing to say about Chevron, and that it did not apply to the issues in this case.

To the extent that the justices' questioning may suggest the justices' views of the merits, there may be cause for concern for the financial services industry. Questions from both conservative and liberal justices suggest that both camps may be more receptive to the textual reading advanced by the Jesinoskis. Regardless of what the court decides, however, this case likely will resolve one of the long-standing issues facing mortgage lenders and investors.

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DISCLOSURE: BuckleySandler LLP filed an amicus brief on behalf of several industry trade associations in the Jesinoski case.

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